MarketWatch
THE WALL STREET JOURNAL.

The Fed

Jan. 27, 2014

Nothing will deter Fed from tapering this week

Market volatility will not persuade them to slow down reduction in asset purchases

By Greg Robb, MarketWatch

WASHINGTON (MarketWatch) — Neither snow, freezing temperatures, market volatility nor a lousy jobs report will stay the Federal Reserve from taking another small step towards the exit this week.

Federal Reserve officials will likely agree on another $10 billion taper to its bond-purchase program after a two-day meeting that ends Wednesday. That's the same pace as the first reduction announced in December and it will bring the monthly purchases down to $65 billion per month, consisting of $35 billion of Treasurys and $30 billion or mortgage backed securities.

The Federal Reserve is on track to trim its bond-buying program for the second time in six weeks, according to interviews with officials and their public comments.

"I think the Fed is desperate to extract itself from quantitative easing, and it will continue to scale back the program and end it this year," said **Bernard Baumohl, chief global economist of the Economic Outlook Group**, in an interview.

Fed chairman Ben Bernanke indicated the Fed wanted to taper at a similar pace to the December move and "now they'll start off on that road," agreed Nigel Gault, co-chief economist at The Parthenon Group in Boston.

The tumble in the stock market over the past two days will not deter the Fed from tapering again, analysts said

“I am not sure what happened over the past two days is yet sufficient to slow them down,” said Dan Greenhaus, chief global strategist at brokerage firm BTIG.

“It is the 11th largest two-day decline in the last two years, it is not a forceful argument to pause,” he added.

Indeed, many experts said it will take something fairly major to blow the Fed off course, either a quicker taper or a pause.

Depending on the circumstances, any shift could be difficult to communicate to markets, Gault said.

One exception to this stance was Jennifer Vail, head of fixed income research at U.S. Bank Wealth Management, who thinks the Fed will probably accelerate the pace of tapering in the summer.

Instead of finishing tapering at the end of 2014, “we expect the Fed to be done with bond purchases by September,” Vail said.

“They want to get out of this business,” she said

The minutes of the Fed’s December policy committee meeting revealed that Fed officials believe the benefits from bond purchases erode over time. Read more about December minutes.

There is also concern about asset bubbles and the $4 trillion size of the central bank’s balance sheet.

This week’s meeting is one of transition, economists said, being the last under Bernanke’s leadership. Janet Yellen will not take over as Fed chairwoman until next month. See slide show of key moments of Bernanke’s tenure.

At the two-day meeting that starts Tuesday, there will be a new set of regional Fed presidents as voters and the group looks a little hawkish relative to last year, said Michael Hanson, U.S. economist at Bank of America Merrill Lynch.

Hanson said Richard Fisher , president of the Dallas Federal Reserve, might dissent in favor of a quicker taper.

Fed officials will debate how to gauge the labor market's strength and what indicators to key on for any hike in short-term interest rates but will make no decisions until Yellen assumes her post, Gault said.

"There is unlikely to be any policy decisions at Bernanke's final meeting," Gault said.

In terms of the January Fed policy statement, "we think less is more," said Julia Coronado, chief U.S. economist at BNP Paribas.

At the moment, the Fed has pledged not to hike its target federal funds rate until "well past" when the unemployment rate falls below the 6.5% threshold. The rate was 6.7% in December.

That pledge, or "forward guidance," is designed to calm financial markets that the central bank will not rush to the exits.

While nonfarm payroll jobs rose by 74,000 in December, the smallest gain in three years, Fed officials made clear in their speeches that the weak report in December would not stop them from tapering again.

Baumohl said the weak job report in December has hurt business and market psychology.

"I just want to see some more data so we can get past that bizarre number," he said.

Despite that weak jobs reading, **Baumohl** and most economists believe the U.S. economy is poised to lift off in 2014, even as similar hopes were routinely dashed since the financial crisis.

"It has a better chance of coming through this year than any of the last three years," Gault said.