

US ECONOMIC OUTLOOK

Q3 2011



13th Sep. 2011

Recovery going from bad to worse

- **Overview** – Recent developments have only reinforced our long-held belief that the economic recovery will remain unusually lacklustre for several more years. We now expect GDP growth of just 1.5% in 2012 and 2.0% in 2013. Only when the structural problems created by the collapse of the housing bubble and the financial crisis are finally resolved will the recovery gather any real head of steam. In the meantime, the low baseline for GDP growth will leave the economy more at risk of slipping back into a recession over the next few years. (Pages 3 & 4.)
- **Consumption** – Households have made only limited progress in reducing their debt burdens following the collapse of the housing bubble. As the deleveraging continues, we expect spending to remain unusually weak over the next couple of years. (Pages 5 & 6.)
- **Investment** – We expect business investment to continue growing at a healthy pace, although there is a danger that the renewed turmoil in financial markets could scare businesses into putting future investment projects on hold. (Pages 7 & 8.)
- **External Demand** – The crisis in Europe and a more widespread easing in global demand means that the export sector won't be able to offset the weakness in domestic demand. (Pages 9 & 10.)
- **Labour Market** – Assuming that another recession is avoided, employment should at least continue to grow, albeit at a very modest rate. Nevertheless, we doubt that growth will be strong enough to lower the unemployment rate, even if the labour force exodus continues. (Pages 11 & 12.)
- **Prices** – Headline inflation should drop below 2% by mid-2012. Unfortunately, we now expect core inflation to continue climbing to just below 2.5% in the spring of next year. It should begin to moderate after that, but we don't expect core inflation to fall back below 1% until 2013 at the earliest. Deflation is still a medium-term risk, but it is no longer the imminent danger that it appeared to be late last year. (Pages 13 & 14.)
- **Monetary & Fiscal Policy** – Policymakers would never admit it, but there is little more they can do to kick start a recovery that, even with the benefit of an unprecedented stimulus during its first two years, has been unusually lacklustre. (Pages 15 & 16.)

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Forecasts

%q/q annualised (unless otherwise stated)	2011				2012				2013				Annual (%y/y)		
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	2011f	2012f	2013f
Demand															
GDP	0.4	1.0	2.5	1.5	1.0	1.5	1.7	1.7	2.0	2.1	2.3	2.3	1.7	1.5	2.0
Consumption	2.1	0.4	2.5	2.0	1.0	1.5	1.7	1.7	1.9	2.0	2.1	2.2	2.2	1.5	2.0
Private Fixed Investment	1.2	8.6	6.2	6.0	5.5	4.8	4.9	5.0	5.0	5.1	5.3	5.5	5.9	5.7	5.2
- Business Investment	2.1	9.9	6.8	5.5	6.0	5.0	5.0	5.0	5.0	5.3	5.8	5.8	7.8	6.3	5.2
- Equipment & Software	8.7	7.8	8.0	7.5	7.2	6.0	6.0	6.0	6.0	6.2	6.5	6.5	9.8	7.0	6.0
- Non-Residential Structures	-14.4	15.8	2.0	0.0	2.0	2.0	2.0	2.0	2.0	2.5	3.0	3.0	2.1	2.5	2.8
- Residential Investment	-2.5	3.4	2.5	2.0	3.0	3.5	4.0	4.5	5.0	5.0	5.0	5.0	-2.0	3.5	5.0
Government Expenditure	-5.9	-0.9	-1.0	-1.5	-1.5	-1.5	-1.5	-1.3	-1.0	-0.5	0.0	0.0	-2.0	-1.2	-0.8
Domestic Demand	0.6	0.9	2.7	2.0	1.5	1.3	1.5	1.9	2.0	2.1	2.3	2.3	1.6	1.4	2.0
Exports	7.9	3.1	8.0	2.0	3.0	3.5	4.0	4.2	4.0	4.0	4.0	4.0	6.9	3.5	3.8
Imports	8.3	1.9	4.3	3.0	2.5	3.0	3.2	3.5	3.7	3.7	3.7	3.7	5.5	2.8	3.5
Labour Market															
Unemployment Rate (%)	8.9	9.1	9.1	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.1	9.0	9.0
Payroll Emp. (Av. Mthly Change, 000s)	140	159	85	100	100	120	120	120	120	120	120	120	120	115	120
Non-Farm Productivity	-0.6	-0.3	1.8	1.0	0.0	0.0	0.5	0.5	1.0	1.0	1.2	1.5	0.7	0.5	1.0
Income & Saving															
Real Personal Disposable Income	1.2	1.0	2.3	2.0	0.3	2.5	2.5	2.5	2.5	2.5	2.5	2.5	1.8	2.0	2.5
Saving Rate (As a % of Disposable Inc.)	4.9	5.3	5.2	5.4	5.1	5.4	5.7	5.9	6.2	6.3	6.4	6.5	5.2	5.5	6.3
Prices (%y/y)															
Consumer Prices	2.2	3.3	3.4	3.1	2.1	1.5	1.2	1.1	1.0	1.0	0.9	0.8	3.0	1.5	1.0
Core Consumer Prices ¹	1.1	1.5	1.8	2.1	2.2	2.0	1.7	1.6	1.4	1.3	1.2	1.0	1.6	2.0	1.2
Case-Shiller National House Prices	-4.9	-5.9	-3.7	-3.0	-2.0	-1.8	-1.0	0.0	0.0	0.2	0.3	0.5	-4.4	-1.2	0.2
Markets (end period)															
Fed Funds Rate (%)	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
10 Year Treasury Yield (%)	3.5	3.1	1.9	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Dollar/Euro	1.42	1.45	1.35	1.30	1.25	1.25	1.20	1.20	1.15	1.15	1.10	1.10	1.30	1.20	1.10
Other															
Current Account (As a % of GDP)	-3.2	-3.3	-3.3	-3.3	-3.4	-3.4	-3.4	-3.4	-3.5	-3.5	-3.5	-3.5	-3.3	-3.4	-3.5
Federal Gov't Balance (As a % of GDP)	-	-	-	-	-	-	-	-	-	-	-	-	-8.5	-6.5	-4.7

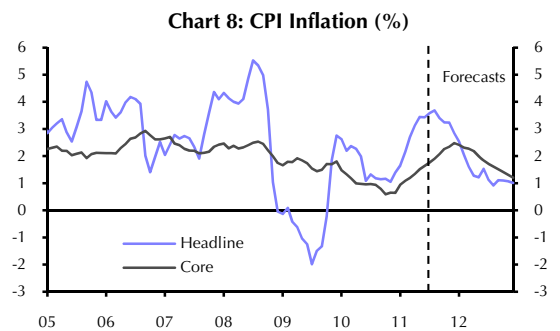
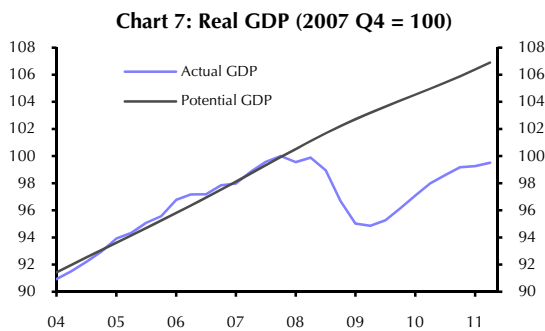
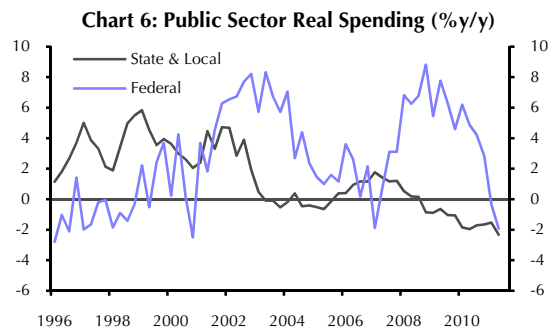
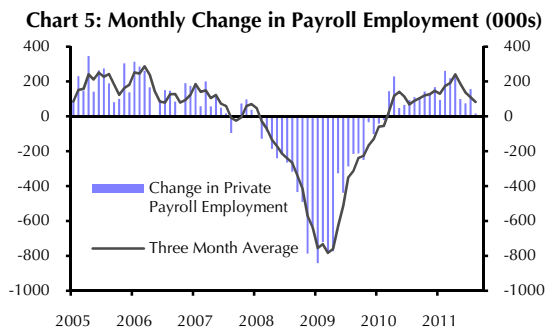
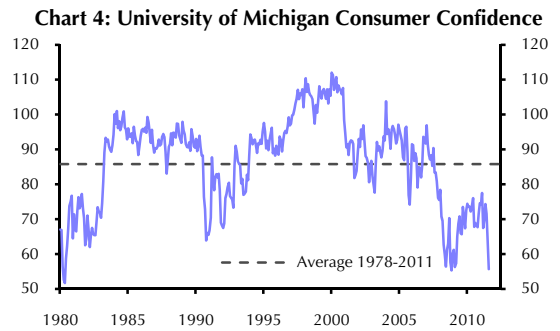
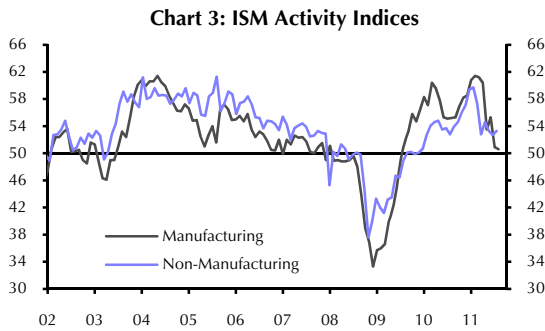
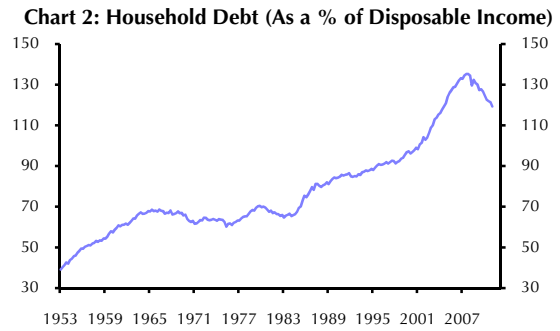
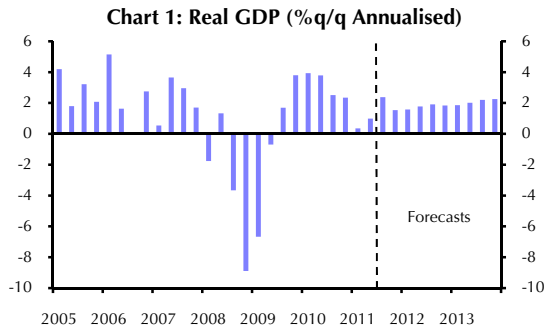
¹ Excluding energy and food.

Overview

Recovery going from bad to worse

- Recent developments have only reinforced our long-held belief that the economic recovery will remain unusually lacklustre for several more years. We now expect GDP growth of 1.7% in 2011 and just 1.5% in 2012, a slight downward revision from our previous forecasts of 2.0% in both years. We still expect growth to be a little stronger in 2013, but only marginally at 2.0%. (See Chart 1.)
- Only when the structural problems created by the collapse of the housing bubble and the financial crisis are finally resolved will the recovery gather any real head of steam. Admittedly, the health of US bank balance sheets has improved markedly over the past few years, as loan default rates have dropped back to more normal levels. Nevertheless, America's financial system is still vulnerable to the crisis in the euro-zone. In addition, households are making slow progress in paying down debt while house prices have continued to edge lower. (See Chart 2.)
- The low baseline for GDP growth will leave the economy more at risk of slipping back into a recession over the next few years. That said, any contraction would presumably be fairly modest since there is little excess to be cut. Business investment is already barely keeping pace with the rate of depreciation, housing starts are below the rate of household formation and vehicle sales are barely above the historical scrappage rate.
- Growth has gradually slowed over the past 18 months, with the surge in commodity prices causing a near-stagnation in GDP in the first half of the year. Most recently, the incoming economic data point to a further deterioration, with business surveys weakening, consumer confidence collapsing and payroll growth grinding to a halt. (See Charts 3, 4, & 5.)
- Unfortunately, at this stage there is little more that policymakers can do to boost the pace of economic growth. The Fed has a few limited options at its disposal, but nothing that we think would make any significant difference to the economic outlook. The bad tempered negotiations over the deal to raise the debt ceiling suggest it is unlikely that Congress will pass the full \$450bn stimulus plan proposed by President Obama. Admittedly the prospect of some limited further stimulus is an upside risk to our 2012 growth forecast. But even if a smaller package is passed, it would probably be too small to make a material difference.
- Without further short-term stimulus, the projected contraction in Federal discretionary spending will compound the ongoing contraction in spending and employment by State and local governments. (See Chart 6.)
- With the actual level of real GDP still not back to where it was before the recession began and more than 6% below the economy's full potential, it is surprising that underlying inflation has recently started to accelerate again. (See Charts 7 & 8.)
- While temporary factors explain some of the resurgence, we expect core inflation to fall back only gradually. Nevertheless, given that the recovery could continue to disappoint for several more years, the threat of deflation is likely to reappear at some point.

Overview Charts



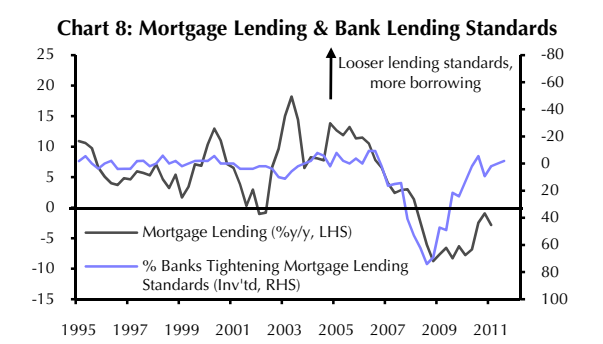
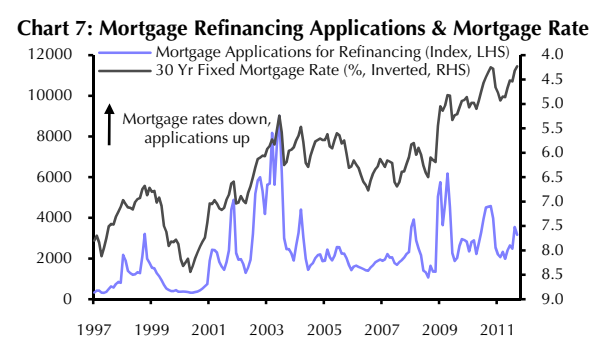
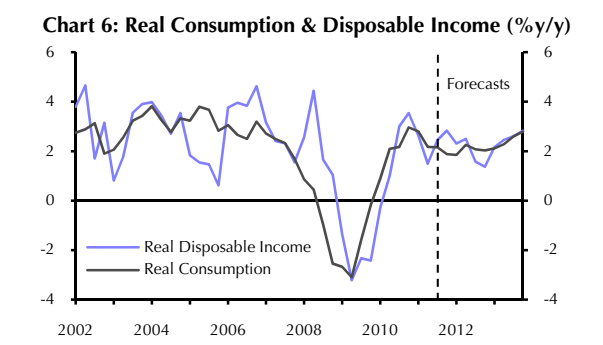
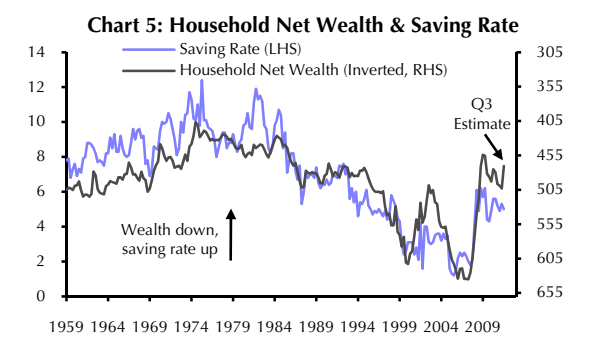
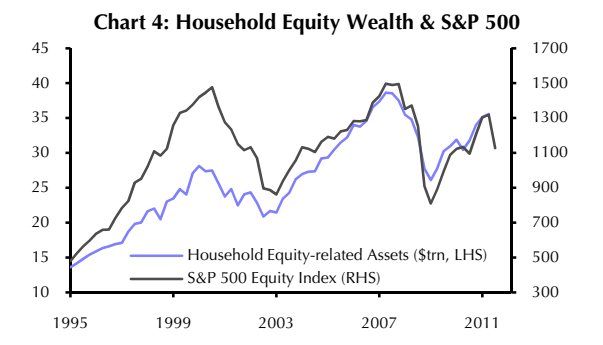
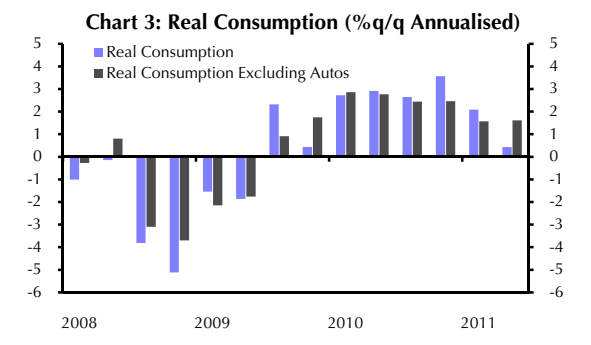
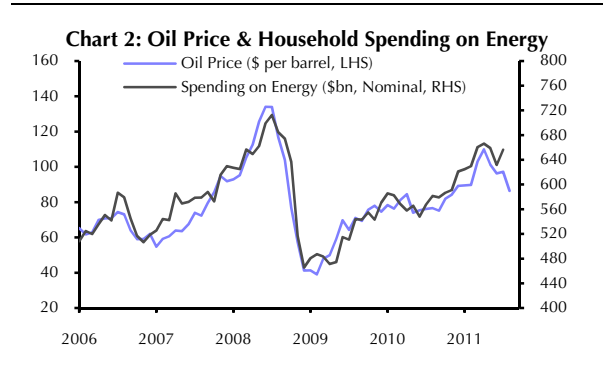
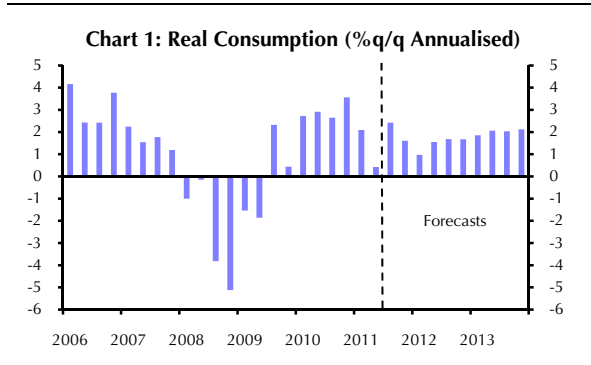
Sources – Thomson Datastream, Capital Economics

Consumption

A further hit to household wealth

- The hit to wealth from the recent plunge in equity prices is one more factor that will hold back household spending. Consumption is set to grow by less than 2% next year.
- Some of the sharp easing in annualised consumption growth, from 3.6% at the end of last year to just 0.4% in the second quarter, will soon be reversed. (See Chart 1.) The fall back in oil prices means it will cost households roughly \$50bn less to buy the same amount of gasoline. (See Chart 2.) That could boost real spending by around 0.5%.
- What's more, a reversal of the 25% annualised fall in vehicle sales in the second quarter, which was due to temporary supply shortages caused by the earthquake in Japan, has the capacity to boost real consumption by over 1%. (See Chart 3.) Indeed, the decent 0.5% m/m rise in real spending in July suggests that annualised real consumption growth in the third quarter may rebound to around 2.5%.
- But the prospects of a stronger and sustained acceleration beyond that have taken a further hit from the recent plunge in equity prices. This may reduce households' equity-related wealth by around \$3.7trn. (See Chart 4.) Based on estimates of the so-called wealth effect, that could eventually reduce consumption growth by up to 1.5%. Lower equity prices have already hit consumer confidence, sending it back to the lows seen during the recession.
- More generally, a further decline in net wealth will provide an even greater incentive for households to shore up their financial position by saving more. (See Chart 5.) At 5% in July, there is scope for the saving rate to rise further towards its long-run average of 7%.
- With employment growth set to remain weak and wage growth still subdued, this won't be achieved by a period of faster income growth. Without a further reduction in the payroll tax rate, real disposable incomes will struggle to grow by more than 2% next year. (See Chart 6.)
- A minority of households may be able to boost their spending by refinancing their mortgage at a lower rate. (See Chart 7.) Historically low mortgage rates may even entice some buyers back into the beleaguered housing market.
- But lower borrowing costs won't boost consumption much when the price of credit is not the problem. Instead, the previous sharp fall in equity prices, the continued decline in house prices and the still high unemployment rate have significantly reduced the ability and willingness of households to borrow.
- A quarter of all homeowners are still underwater on their mortgage and another quarter have less than 20% of positive home equity. These households are unable to borrow even if they wanted to. This explains why, despite banks having become more willing to lend, mortgage lending has continued to fall. (See Chart 8.)
- This dearth in demand will persist for a number of years, constraining consumption growth beyond 2012 too.

Consumption Charts



Sources – Thomson Datastream, Capital Economics

Investment

Business investment still a relative bright spot

- Business investment has been one of the few bright spots in what has been an otherwise very disappointing recovery. We expect business investment to continue growing at a healthy pace, although there is a danger that the renewed turmoil in financial markets could scare businesses into putting future investment projects on hold.
- In the early stages of the recovery business investment in equipment and software rebounded very rapidly, as the pent up demand that built up during the recession was worked through. Admittedly, more recently the growth rate of that spending has slowed. But thankfully that moderation has been offset by a recovery in investment in non-residential structures. (See Chart 1.)
- Renewed turbulence in financial markets and increased concerns about the economic outlook have already hit business survey measures of capital expenditure intentions. (See Chart 2.) The survey evidence points to a renewed decline in investment in commercial real estate too. (See Chart 3.)
- Despite the rebound in business investment, the capital expenditure of non-financial firms is still running at barely more than the rate of depreciation. This helps to explain why the recovery in the labour market has been so lacklustre. (See Chart 4.) Businesses are mostly spending to replace worn out equipment. Only when businesses start to expand their capital stock will they need to take on additional employees.
- Low borrowing costs have encouraged businesses to expand their borrowing in the commercial paper market and from commercial banks. (See Chart 5.) Corporate bond issuance was also very strong in the first half of this year. Unfortunately, firms appear to have used this money to increase liquidity or fund mergers and acquisitions, rather than use it for investment.
- More generally, the recovery in corporate profits has been particularly impressive given the weakness of the recovery in real GDP. Corporate profits have rebounded to a record high, accounting for almost 13% of nominal GDP. (See Chart 6.)
- While business investment has staged a decent recovery since the recession, residential investment, and the housing market in general, are still at rock bottom. Housing starts and new home sales have shown no real signs of recovery at all. (See Chart 7.)
- Homebuilding activity will eventually have to rebound because the number of new homes being built is well below the normal rate of household formation. Unfortunately, with so many foreclosed homes still to come onto the market, it could be another few years before this recovery materialises.
- Finally, inventory levels look about right relative to sales. (See Chart 8.) We anticipate some rebuilding of motor vehicle inventories now that production is rebounding, but that will probably be offset by a run down in other inventories.

Investment Charts

Chart 1: Business Investment (%q/q Annualised)

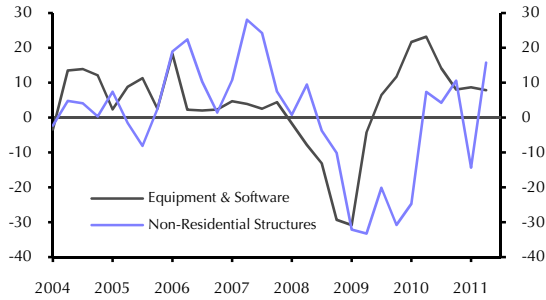


Chart 2: Capex Intentions (Ave. of Philly Fed/Empire St. Ind.)

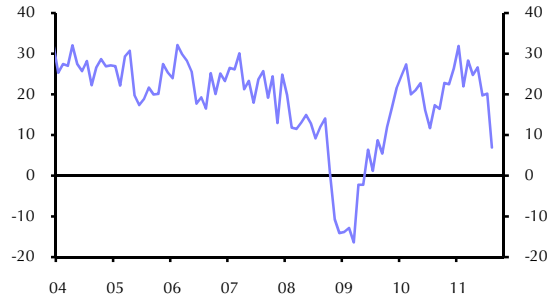


Chart 3: Non-Residential Construction Spending & ABI

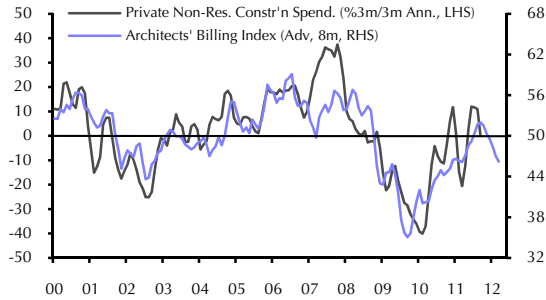


Chart 4: Business Investment & Unemployment Rate

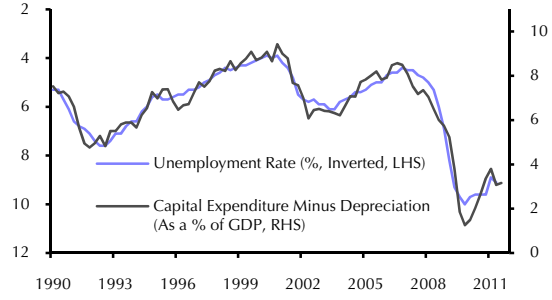


Chart 5: Non-Financial Corporate Debt (\$bn)

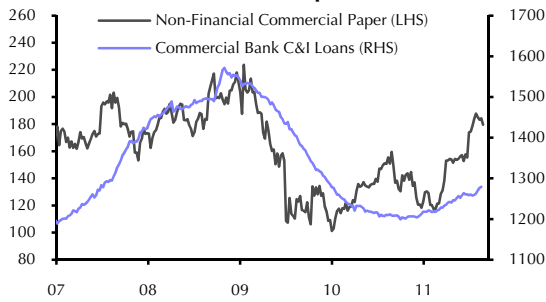


Chart 6: Corporate Profits (As a % of GDP)

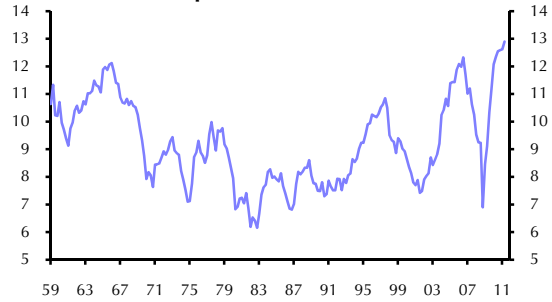


Chart 7: Housing Starts & New Home Sales (Million)

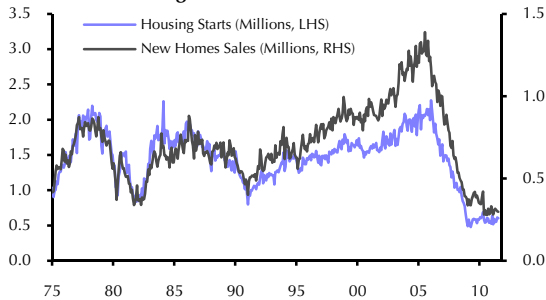


Chart 8: Business Inventory-To-Sales Ratio (%)



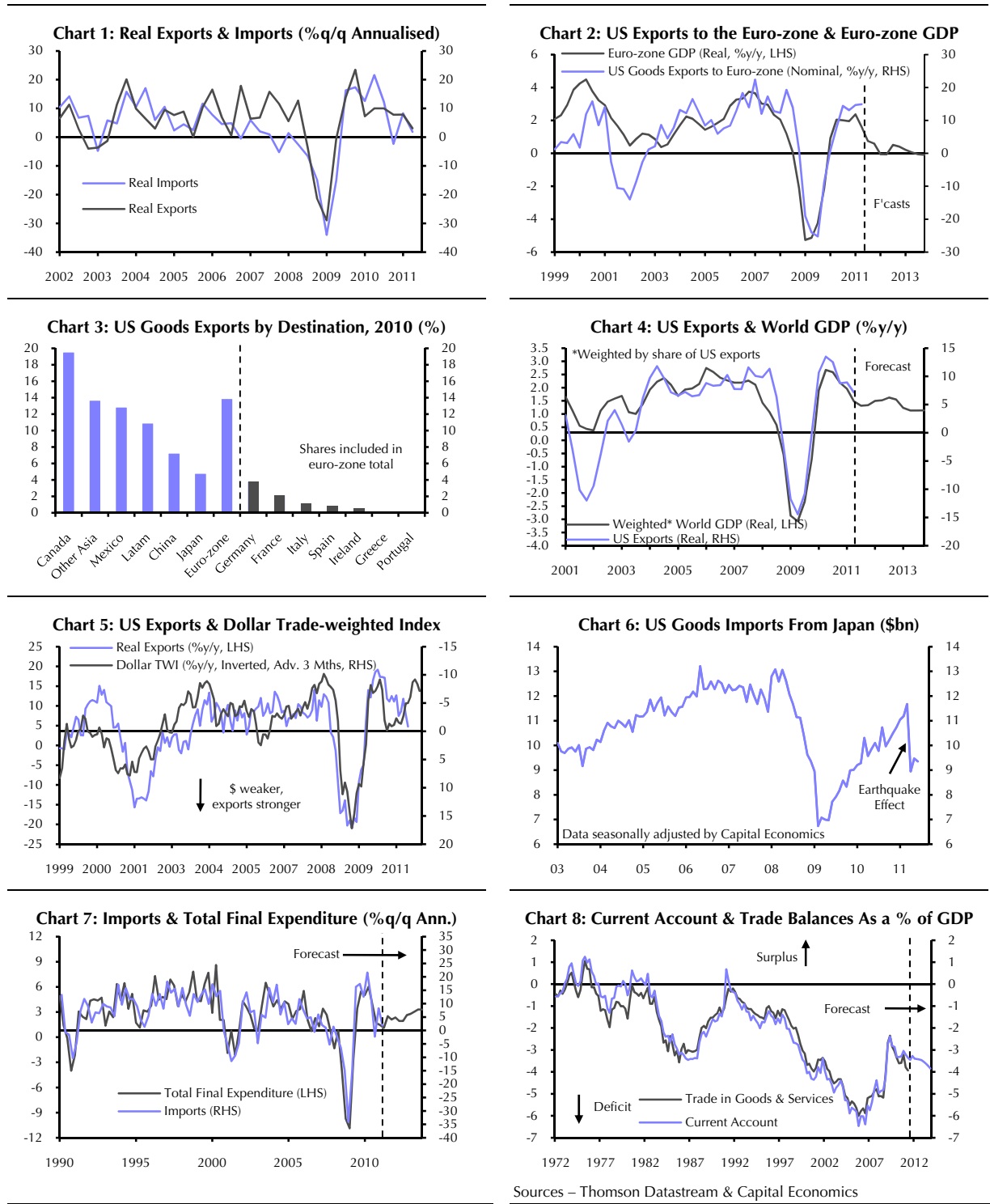
Source – Thomson Datastream

External Demand

No offsetting boost from overseas

- The crisis in Europe and a more widespread easing in global demand means the export sector won't be able to offset the weakness in domestic demand. With both monetary and fiscal policy largely tapped-out, policymakers may try to change this by considering trade protectionism policies. This would be controversial, but it could prove to be a vote winner in next year's Presidential election.
- The recent softening in overseas demand has already hit US exports, with the annualised growth rate slowing from 8% in the first quarter to just 3% in the second. (See Chart 1.) The drag on US exports from the fiscal crisis in the euro-zone is only likely to grow. Our forecasts for euro-zone GDP are consistent with US exports to the currency union hardly rising at all. (See Chart 2.)
- Thankfully, the US sends just 14% of its exports to the euro-zone. Less than 3% in total go to Italy, Spain, Ireland, Greece and Portugal. (See Chart 3.) The US is more exposed to Canada, Mexico and Asia. But demand in those areas will ease too, meaning that US exports are unlikely to rise by more than 5% a year. (See Chart 4.)
- Against a backdrop of a weaker global economy, the lower dollar is unlikely to help much. (See Chart 5.)
- In contrast, at least some of the recent slowdown in import growth, from 8% in the first quarter to just 2% in the second, is temporary. Part of it was due to a 23% fall in imports from Japan triggered by the earthquake. (See Chart 6.) Now that Japanese auto production has resumed, US imports from Japan should start to rise back.
- More generally, even our tepid forecasts for the strength of the domestic economy are consistent with import growth gradually accelerating towards 10%. (See Chart 7.)
- The upshot is that net trade is set to be a modest drag on economic growth both in the second half of this year and throughout next year too. The current account deficit may therefore gradually widen from 3.2% of GDP in the first quarter to close to 4% of GDP by the end of 2013. (See Chart 8.)
- At a time when the unemployment rate will still be high and GDP growth will still be weak, a larger current account deficit may lead to louder calls for protectionism trade policies. Of course, import tariffs are not the first-choice policy option. But with conventional policies largely exhausted, they could be alluring.
- Given that the US runs a larger trade deficit with China than with all other nations put together, any protectionist policies are likely to focus initially on China. But they may need to be extended to other low-cost producers.
- Of course, those countries will retaliate with their own tariffs on US imports. But as the US is running a current account deficit, it will benefit in net terms. Closing the deficit would boost GDP by 3%. Ahead of the 2012 Presidential election, boosting growth at the expense of other countries could be appealing.

External Demand Charts



Labour Market

Unemployment rate to remain stranded close to 9%

- The labour market recovery has ground to a halt. In just a matter of months the economy has gone from generating over 200,000 net new jobs per month to creating no jobs at all in August. We expect that conditions in the labour market will remain unusually weak for another year or two, with the unemployment rate remaining stranded at close to 9%.
 - significantly reduce the unemployment rate. By the end of next year, it will still be close to 9%. (See Chart 5.)
- The decline in the unemployment rate over the past 12 months has been mainly due to an exodus from the labour force. The employment-to-population ratio has actually continued to trend lower, hitting a 28-year low. (See Chart 1.) Slower labour force growth is the key reason why we don't expect the unemployment rate to rebound over the next year or two.
 - The longer the unemployment rate remains high, the greater the likelihood that it is being boosted by structural as well as cyclical forces. The rise in the jobs opening rate relative to the unemployment rate suggests that skills and location mismatching may be preventing the unemployed from filling vacant positions. (See Chart 6.)
- As the number of initial jobless claims has stayed close to 400,000, the latest slowdown in jobs growth has been driven by less hiring rather than more firing. (See Chart 2.). The recent outright falls in temporary employment, which tends to lead permanent employment, suggest that jobs growth will remain weak in the near-term. (See Chart 3.)
 - If the relationship seen before the recession had held, the rise in the jobs opening rate would have been accompanied by a fall in the unemployment rate to around 6.5%. This may explain, at least partly, why average hourly earnings have not started to contract.
- The main problem is that businesses do not expect the economy to improve by enough to justify taking on more workers. (See Chart 4.) Given that productivity fell in the first half of the year, there is a danger that firms will try to make further efficiency gains by letting more workers go.
 - But for the labour market to put upward pressure on wage growth, the unemployment rate would probably have to fall below 6%. In other words, the labour market will remain a disinflationary force for some years yet.
- Assuming that another recession is avoided, employment should at least continue to grow at modest rates. That, however, will not
 - Admittedly, wage growth has not fallen as far as the rise in the unemployment rate implies. (See Chart 7.) However, the experience of Japan shows that it can take many years for wage deflation to kick-in. (See Chart 8.)
 - Overall, the prospect of the unemployment rate remaining persistently high means that wage deflation cannot be ruled out.

Labour Market Charts

Chart 1: Unemployment & Employment to Population Rates

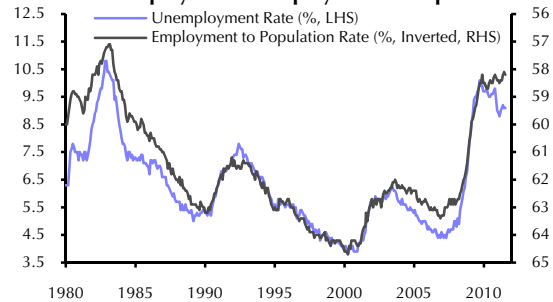


Chart 2: Initial Jobless Claims (000s)

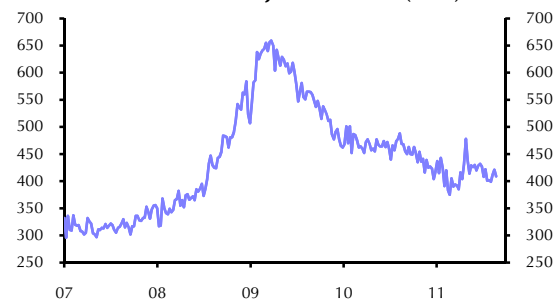


Chart 3: Change in Temporary & Permanent Payrolls (000s)

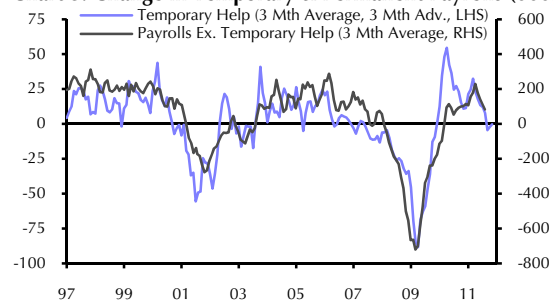


Chart 4: GDP & Non-Farm Payroll Employment (%/y)

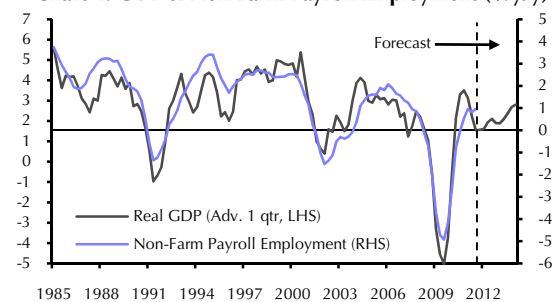


Chart 5: Unemployment Rate & Natural Rate (%)



Chart 6: Beveridge Curve, December 2010 to July 2011

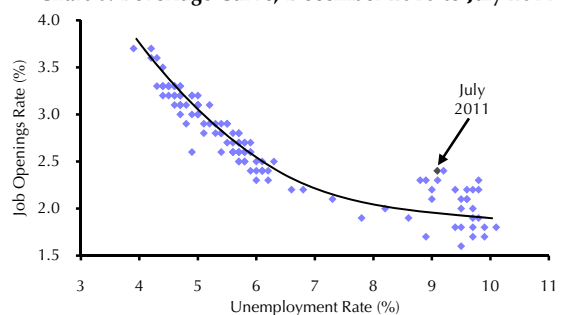


Chart 7: Average Earnings & Unemployment Rate

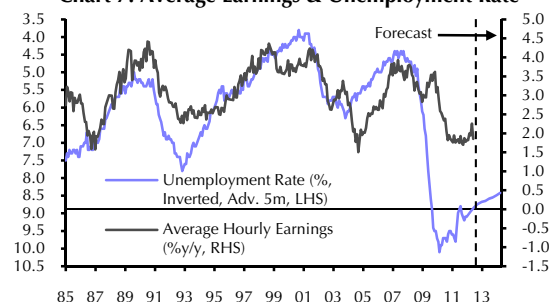
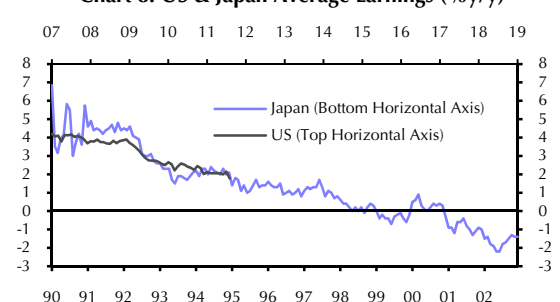


Chart 8: US & Japan Average Earnings (%/y)



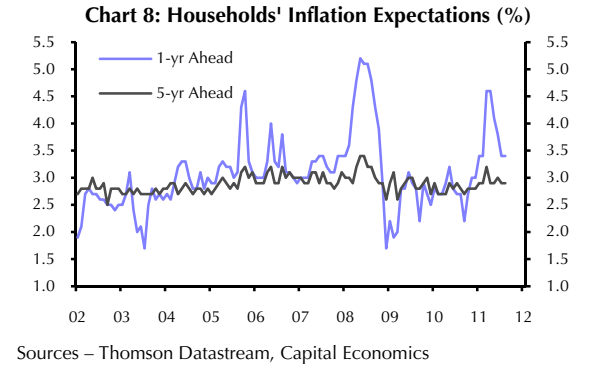
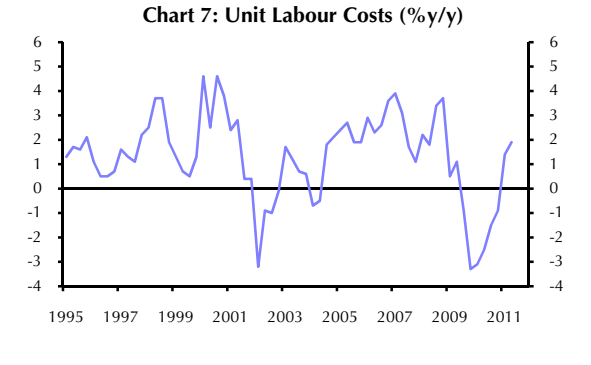
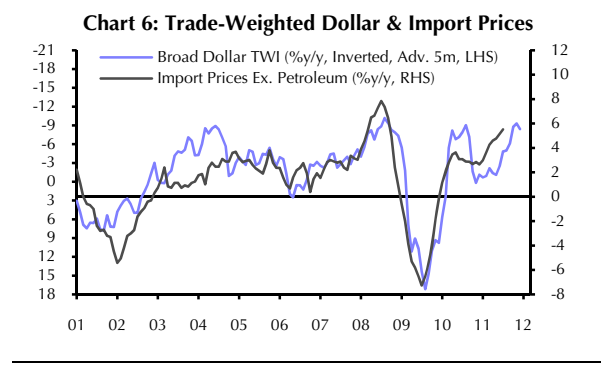
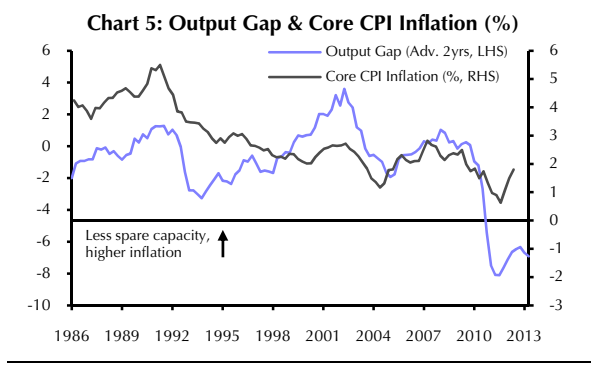
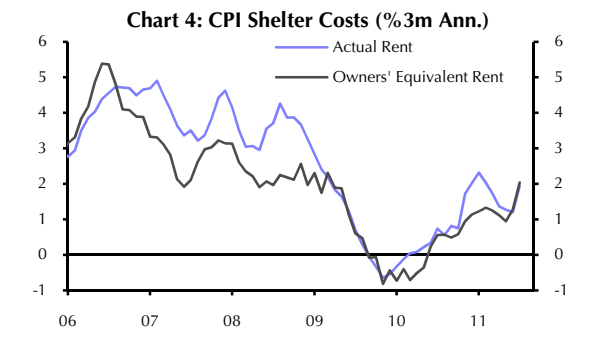
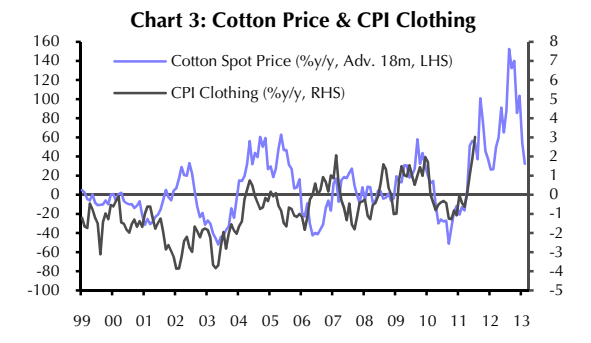
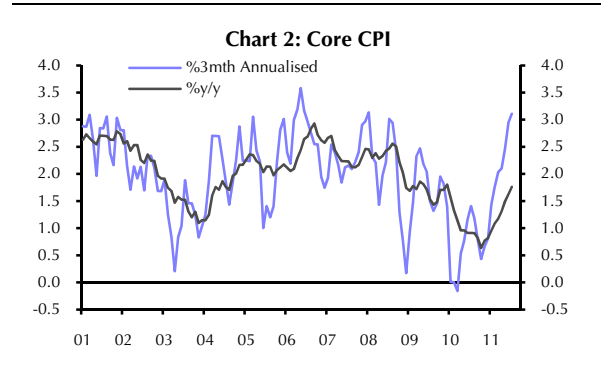
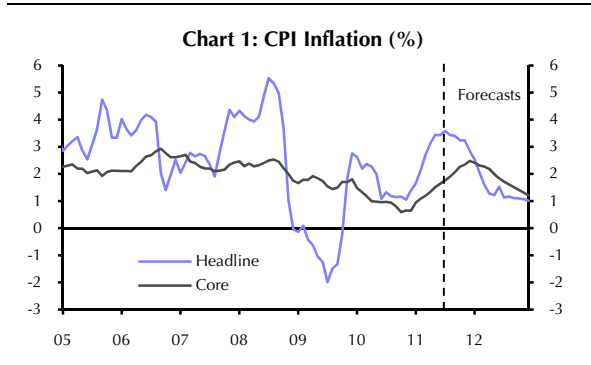
Source – Thomson Datastream, Capital Economics

Prices

Rebound in core inflation has further to run

- Headline inflation should peak at just below 4% over the next few months and, with energy prices having fallen, it should moderate to less than 2% by mid-2012. (See Chart 1.)
 - Unfortunately, we now expect core inflation to continue climbing, from 1.8% in August to just below 2.5% in the spring of next year. It should begin to moderate after that, but we don't expect core inflation to fall back below 1% until 2013 at the earliest. As far as we are concerned, deflation is still a medium-term risk, but it is no longer the imminent danger that it appeared to be late last year.
 - The turn around in core inflation has been dramatic, with the three-month annualised rate rising from below zero in early 2010 to a near decade-high of more than 3% in August. (See Chart 2.) Some of the rise is due to temporary factors, but not all of it and even those temporary factors may persist for some time.
 - The rapid rise in motor vehicle prices in the wake of the Japan-related disruptions to supply is now beginning to unwind. On the other hand, despite the drop back in raw cotton prices, the surge in finished CPI clothing prices may continue for as long as another 18 months. (See Chart 3.)
 - In addition, the turnaround in the growth rate of housing costs is probably here to stay as well. The US CPI incorporates housing costs using actual and imputed rental values. Those housing costs did fall briefly in early 2010, as the long decline in house prices led to a modest dip in rents. Since then, however, there has been a rebound in the growth rate of rents.
- With markedly fewer people looking to buy a home, principally because they no longer qualify for a mortgage, the demand for rented accommodation has continued to strengthen and we expect it to remain strong.
- The rebound in core inflation is very hard to square with current measures of the amount of spare capacity available in the economy. With an output gap of still more than 6% of GDP, the Phillips Curve relationship suggests that core inflation should be below zero by now. (See Chart 5.) Possibly the output gap is smaller than most estimates suggest or perhaps it is just taking a lot longer for the disinflationary pressure to feed through.
 - The recent surge in the global price of most commodities explains some of the discrepancy, but not all of it. More generally, the falling dollar is putting some modest upward pressure on imports prices but, except for 2009, this has been the case consistently since 2003. (See Chart 6.)
 - Even on the domestic front, the marked turnaround in the growth of unit labour costs suggests that the rise in underlying inflation won't be quickly reversed. (See Chart 7.)
 - Finally, the decline in energy prices has led to a sharp drop back in short-term inflation expectations, which is similar to what happened in 2009. (See Chart 8.) As it stands now, consumers don't appear to be overly worried about either deflation or runaway inflation.

Prices Charts



Sources – Thomson Datastream, Capital Economics

Monetary & Fiscal Policy

Options for further policy stimulus now limited

- Policymakers would never admit it, but there is little more they can do to kick start a recovery that, even with the benefit of an unprecedented stimulus during its first two years, has been unusually lacklustre.
- President Obama has proposed a new \$450bn stimulus, worth close to 3% of GDP. If passed, this would make a significant difference to our 2012 GDP forecast. But given how hopelessly divided Congress currently is, we suspect that the chances of any stimulus being passed, even a smaller one, is less than 50 per cent.
- The two parties did eventually agree on a last-minute deal to raise the debt ceiling in early August. Nevertheless, that agreement, which will reduce projected discretionary spending by less than \$1trn over the next ten years and seek further budget cuts worth an additional \$1.5trn, was still well short of what was needed to stabilise the Federal debt.
- Our latest projections suggest that the Federal deficit should eventually level out at about 4% of GDP. (See Chart 1.) Nevertheless, even under that scenario we would still expect the overall debt burden to exceed 80% of GDP by the end of the decade. (See Chart 2.)
- As Chart 3 shows, discretionary spending is now projected to shrink in 2012 and 2013.
- Despite the downgrade in the US credit rating by S&P, the markets now think that Federal government debt is safer than German Bunds. (See Chart 4.) Treasury yields have also fallen further, in response to signs that the US economic recovery is stalling and the turmoil in the euro-zone. (See Chart 5.) We expect yields to remain low for an extended period.
- The Fed has already strengthened its guidance on short-term interest rates, saying that it expects to leave them close to zero until at least mid-2013. That commitment has helped to lower the short end of the yield curve and it looks like that will be followed soon by action to lower longer term yields. (See Chart 6.) We expect the Fed to begin selling some of its Treasury holdings with shorter maturities in order to extend the average duration of its portfolio.
- What has been dubbed Operation Twist might succeed in reducing lowering 10-year Treasury yields a little, but we doubt it will have any impact on the wider economy because the cost of borrowing isn't the problem. Households aren't in a position to borrow more or even refinance their mortgages to take advantage of these lower rates. Similarly, businesses don't have the confidence to invest regardless of how cheap the funds are.
- There seems to be little enthusiasm at the Fed for another round of quantitative easing, which would expand its asset holdings by increasing bank reserves and boosting the money supply further. (See Chart 7.)
- The only other possibility is that the Fed could cut the interest rate it pays on those bank reserves, which is currently set at 0.25%. (See Chart 8.) Unfortunately, with the effective fed funds rate already below 0.10%, the impact of such a move would be marginal at best.

Monetary & Fiscal Policy Charts

