**From:** US GIO <[redacted]>
**Sent:** Tuesday, August 28, 2012 1:01 PM
**To:** Undisclosed recipients:
**Subject:** J.P. Morgan Macro Skinny: Don't count on QE3 until it hatches

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Don't count on QE= until it hatches

1/ Those hoping the Federal Reserve will soon announce another round of =alance sheet expansion found support in the release of the August 1st=/sup> FOMC meeting minutes last week. More specifically, the minutes ind=cated the Fed is inclined to embark on additional asset purchases &#=220;fairly soon", unless we observe a "substantial and sustainable strengthening" in economic activity<=up>1. Furthermore, if "QE3" is to be enacted, the Fed =ould likely make it open-ended, i.e., purchases will last until =he data tell it to stop2. We were surprised by this tone, as =e thought the Fed held the same view as us - that the weakness in Q2 was t=ansitory.

<=pan style="color:black">2/ The backdrop for the August 1st</=up> meeting was indeed weak: three consecutive payroll releases in the 60-=0K range, three straight retail sales in negative territory (first time si=ce '08) and a dip in the ISM manufacturing to below 50. Sinc= the meeting, however, incoming data were broadly stronger: 163K in July p=yrolls and a very strong rebound in retail sales. On the downside, durab=e goods orders were very weak, which in our estimation reflects the =orsening crisis in Europe in June-July3. If true, the sharp d=cline in orders should partially rebound, following the dramatic shift in =CB policy. We will be watching the next batch of manufacturing surveys f=r signs of stabilizing export orders.

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3/ A few Fed speakers confirmed that the mi=utes are now somewhat outdated. Speakin= to CNBC late last week, St. Louis Fed President Bullard remarked that t=e minutes are "stale" and that "some data since [the Aug=st FOMC meeting] is stronger." More broadly, the tone was more upb=at than his July 16 interview. Atlanta Fed President Lockhart, oft=n seen as a median voter on the FOMC, has also acknowledged the recent str=ngth in the data; comparing his August 23rd interview to his Ju=y 13th interview, Lockhart seemed to have materially shifted =0A his stance4.

4/ Upcoming data will likely sta= relatively upbeat. Based on fewer new claims for unemployment insurance=in August, the next payroll report should be nearly as strong as the July =ne5. It's still too early to gauge how August ret=il sales are shaping up, but our best guess is that spending will remain b=tter than in the March-June period, in part, thanks to the acceleration in=real income. Finally, business sentiment will probably look a touch bett=r, as the new ECB policy initiative gradually rebuilds confidence in=the region. All in all, we think the data will look better in the coming=2-3 months. It is hard to judge whether this improvement qualifies as &#=220;substantial and sustainable strengthening", but at the ver= least, we think the data will convince the Fed to "wait and seeR=1;.

5/ So wh=t can we expect from the Jackson Hole symposium? Since it's an acade=ic forum, new ideas for monetary policy, such as the ones recently c=nsidered by the Fed, ECB, and the Bank of England, will likely be me=tioned. But we caution against expecting a repeat of the 2010 symposium,=where Bernanke telegraphed QE26. Bernanke may well mention th= scope for more accommodation, but he is likely to emphasize the condition=lity of new easing, especially in light of improving data and Draghi=lowering the downside risk from Europe. Draghi was originally slated to =peak at Jackson Hole, but announced today that he will remain in Frankfurt=to hammer out the operational and technical details of the ECB's new=bond-buying plan.

6/ As for the following Fed meeting=, the trivial way forward for the Fed is to deploy the communication tool = extending the period for which "rates will remain exceptionally low=#8221; from "late 2014" into 2015. This policy move, w=ich we think will be announced in the September meeting, represents more o= an update than a means of monetary accommodation. Meanwhile, Operation =wist 2.0 is still ongoing, and given the better momentum in the data, we=think the Fed will adopt a wait-and-see approach for a few more mont=s, contrary to what the August meeting minutes suggest. If we do get ano=her round of asset purchases eventually, it will probably be in response t= a badly managed fiscal cliff. We still think this possibility is =ore likely to materialize around the turn of the year.=/p>

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[1] To quote from=the minutes: "Many [of the 12 voting] me=bers judged that additional monetary accommodation would likely be warrant=d fairly soon unless incoming information pointed to a substantial a=d sustainable strengthening in the pace of the economic recovery."=o:p>

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[3] Comments from the Beige Book prepared for the Augus= FOMC meeting support the pullback in demand from Europe. In particular,=the Cleveland Fed reported that they "continued to hear reports about a weakening in orders from European cus=omers"; in the Richmond Fed district, "A producer of gas turbi=es said that economic problems in Europe had reduced his company's exports=by fifty percent"; and, the Chicago Fed noted, "exporter= noted a decline in demand from Europe in China."

[4] In a 21 August speech, Dennis Lockhart commented that "th=re is a risk to monetary policy being employed too aggressively." =his signifies a pullback from his 13 July comments where he said wit=out employment growth the current policy stance will become "untenab=e" and the Fed will need to do more.

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The July employment report s=owed an increase of 163k nonfarm jobs. Since the number of initial joble=s claims declined from 388k during the payroll survey week in July t= 372k in August, this suggest another month of payrolls in the neighborhoo= of 150k.

=p class="MsoNormal">[6] <=span>The title of Chairman BernankeR=7;s speech, "Monetary Policy Since the Crisis," suggests his c=mments are likely to be backward-looking, rather than a projection o= policy. Another reason he is less likely to use the Jackson Hole forum =o discuss policy is that he now regularly has the opportunity to address p=licy following FOMC meetings (four times each year). Press conferences d=d not begin until April 2011 (after his August 2010 "QE2"= speech).

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Acronyms:

ECB =#8211; European Central Bank

Fed – Federal Reserve

FOMC –= Federal Open Market Committee

QE – Quantitative Easing

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