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The Fed announced that it would stop purchasing U.S. Government debt by October 2009. This is an important decision. The purchases, designed to lower long-term interest rates, have been a “lifeline” for cash-strapped companies and households.

The FED is assuming that the recession is over and excess liquidity can be withdrawn from the economy. If this is true, the Fed should indeed withdraw liquidity to prevent an increase in inflation. If this is not true, the FED’s action will actually prolong the recession.

So, is the recession over? Most pundits argue that the worst is over. They point to the drop in the unemployment rate, fewer first time jobless claims and an increase in consumer confidence.

The worst is not over until the hemorrhaging of jobs is over, and the hemorrhaging of jobs is not over. Companies continue to layoff workers, government debt continues to grow unabated, consumers continue to save instead of spend, banks continue to improve leverage instead of lend, and foreclosures continue to mount. These are uncertain times, and any policy that assumes we are out of the woods will cause serious harm to an already weak economy. The FED best be careful.