

with household balance sheets well repaired and fiscal drag set to be much smaller than it was this year. I do not expect any significant downward revision to the FOMC's economic projections for growth. Indeed, they may well mark down the projected path of the unemployment rate.

Con: Weakness in business investment spending, and more recent softness in capital goods orders augurs against the sort of self-sustaining economic recovery that the center of the FOMC has indicated they need to see to begin to taper. Homebuilding too has softened in the wake of the taper tantrum.

Bottom line: growth performance and prospects have strengthened just barely enough to warrant a December taper.

c. Inflation.

Pro taper: The FOMC has been projecting inflation to return to 2% over the next several years. Long-term inflation expectations have been well anchored within their recent historical ranges; wage inflation has at least leveled off, and some indicators have been rising.

Con: Core PCE inflation is now uncomfortably low after trending down over the past two years. It declined again in October, though those numbers may have been tainted by the government shutdown.

Bottom line: Recent inflation performance comes down clearly against a December taper, but that could change with an upside surprise to core CPI numbers for November tomorrow (Tuesday)—a reading of 0.2 to 0.3 would help).

Bottom line on overall economic conditions: slightly in favor of Dec. taper

2. Costs of QE (potential froth in credit markets, interference with markets, fiscal costs or possible losses in Fed net income down the road).

Pro taper: costs are rising, not declining, many/most on the FOMC would like to end the program, everything else equal. Fed folks have been saying for some time that they wanted to begin to taper by the end of the year, and this is why. While asset valuations do not look extreme, there has been a certain amount of reaching for yield, and if QE continues at this pace for much longer, valuations could become stretched.

Con: FOMC leadership has indicated that they do not see significant signs of financial instability associated with balance sheet expansion, they do not see markets malfunctioning, and they are not too concerned about fiscal issues down the road, given that the Fed is not likely to sell MBS or long-term Treasuries any time soon. This suggests that they would not be driven to taper in the near term by cost considerations.

Bottom line on costs: neutral on December taper

3. Fiscal uncertainties: this was a key factor behind the September surprise, but these uncertainties have now been largely resolved, with the budget deal currently in the works set to reduce fiscal drag in 2014 even further. Modest risk remains around debt ceiling, but a blowup seems quite unlikely in an election year.

Fiscal: Pro Dec. taper.

4. Communications strategy:

Several FOMC participants have advocated announcing an explicit schedule for winding down QE with the initial taper. Doing so could push the bar for the initial taper somewhat higher and augur for delaying it a bit further so that they can be more confident they will not have to interrupt the exit process.

Communications: slight Con.

5. Market liquidity: Thin markets in second half of December, raise the possibility of an exaggerated negative price reaction, which could put a damper on confidence and on retail sales in the final days of the holiday