Kudlow's Commentary

Thumbs up Fed, Thumbs Down Washington

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The Fed was very gloomy in its Open Market Committee statement today. It suggested a gradual recovery could begin later this year, although there are plenty of downside risks. The Fed will keep its target rate near zero, and will keep expanding its balance sheet by purchasing plenty of government-sponsored debt and mortgage-backed securities. Its so-called TALF plan to finance consumer-related bonds will begin soon. It might even buy Treasuries, even though it can't quite make its mind up on that. Taken together, these actions will keep injecting more cash into the financial system.

All of this is reasonably good, and one wonders why the Fed can't unclog the credit system on its own without new government banks to purchase toxic assets. It's possible to design a so-called government "bad bank" to buy distressed assets without nationalizing the banks. Team Obama seems to be leaning against nationalization. As Holman Jenkins points out, we know that depositors and creditors are secure. But bank stocks have had a terrible ride because shareholders have no such security.

There's a lot of talk that a government bad bank could be modeled after something like the old Resolution Trust Corp. But this would require regulatory accounting forbearance of the punitive mark-to-market approach. It could be done if the SEC would work in connection with a new bad bank. And it might help get private investors engaged in buying toxic assets from the bad bank if the capital-gains tax was suspended for a couple of years.

Meanwhile, important *forward*-looking economic indicators suggest we have seen the bottom -- believe it or not.

First and foremost, stocks bottomed in late November and are about 15 percent higher today. Raw commodity indexes have bottomed. 10-year Treasury rates have bottomed and yields today are about 50 basis points higher. Oil prices have bottomed. And the dollar bottomed many months

ago. Plus, the Fed's monetary-base expansion has produced about a $550 billion increase in the M2 money supply, which could start raising the economy as early as this spring.

If the turnover rate of money -- that is, velocity -- moves back to its 10-year average, then we could all be surprised by a *substantial* economic rebound starting this spring or summer.

I'm not even going to mention the goofy stimulus package in Congress, because it's not going to stimulate much of anything except a zillion Democratic political-interest groups. This package is completely porked up with massive social spending and other political targets -- none of which will create any jobs or growth. It's just a massive resource transfer.

And the infrastructure bailout turns out to be vastly smaller than originally advertised. In the 1950s, Ike launched a $550 billion highway-building plan. Today's stimulus package has $30 billion in highway-related projects, and perhaps another $40 billion way down the road for broadband and electric-grid-type developments.

The public expected an infrastructure build-out that actually made some sense. That's not what they're getting. And if Republicans keep hammering away at this they are going to make important political points and slow down the Obama train.

In the meantime, the Fed is doing its job. So is the big energy tax cut. As free-market indicators suggest, the economy may well be heeling faster than Washington can cobble together the most unmanageable fiscal activity anyone has ever seen.

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