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Fed Watch

US

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Economic Analysis

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FOMC Statement: January 29-30th

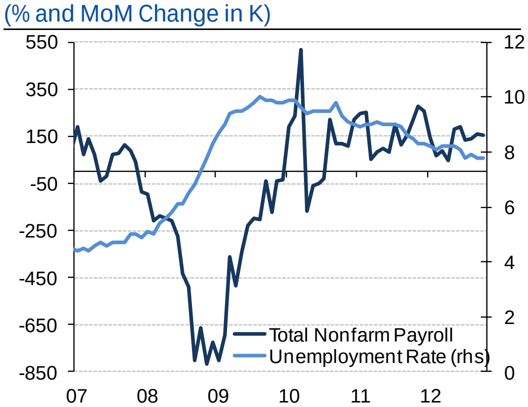
Recent Data Not Enough to Shift FOMC Policy Decisions, Yet...

- Asset purchases will continue alongside near zero interest rates
- Overall economic activity paused, but stronger business investment
- End to QE3 still in sight, possibly slowing by mid-2013

Today's FOMC meeting announcement lived up to our expectations for unchanged monetary policy accommodation to start 2013. The Committee agreed to maintain its current asset purchase program outlined in previous months, including purchases of $40bn per month in mortgage-back-securities (MBS) and $45bn in longer-term Treasury securities. Also, the FOMC decided to continue its policy of reinvesting principle payments into MBS and rolling over maturing Treasury securities at auction. As always, the FOMC will continue the ongoing purchases while closely monitoring the efficacy and cost of these actions that might lead to a reassessment of the size, pace and composition of purchases. Furthermore, the Committee will be ready and willing to "employ other policy tools as appropriate" if labor market conditions do not significantly improve. The statement also reemphasized the plan to keep the target interest rate near zero for "at least as long as" the unemployment rate is above 6.5% and inflation remains no more than 2.5% between one and two years from now, with long-term inflation expectations well anchored. FOMC members will monitor other economic data as well, emphasizing the fact that these policy guidance thresholds are merely guidelines, not immediate triggers. Another important factor in the Fed's communication is that they have been very clear about this highly accommodative stance remaining "appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens."

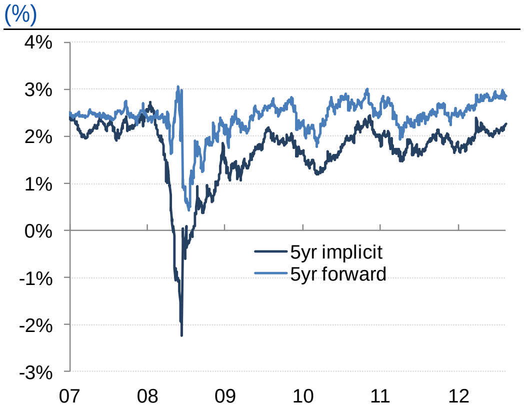
The single vote against the action was Esther George from the Kansas City Federal Reserve, who argued that continuing such accommodation could cause future imbalances and an increase in long-term inflation expectations. As outlined in our overview of the new FOMC voting members for this year (FOMC preview), George is the most hawkish of the newcomers and is likely to follow in the footsteps of exiting fellow hawk Jeffrey Lacker as the consistent dissenter throughout the year.

Chart 1
Unemployment Rate and Nonfarm Payrolls
(% and MoM Change in K)



Source: Bureau of Labor Statistics & BBVA Research

Chart 2
Inflation Expectations
(%)



Source: Federal Reserve & BBVA Research

In regards to the Fed's outlook, the FOMC statement today noted that "economic activity paused in recent months," in contrast to the December statement that reported expansion at a "moderate pace." At the same time, the statement discounts the negativity as "weather-related" and "transitory factors" and it is unlikely that today's disappointing report on 4Q12 real GDP had any impact on the sentiment. The FOMC appears to be more optimistic regarding business investment, which had shown signs of slowing according to the December statement but has since advanced throughout the intermeeting period. Inflation remains under control, with mid- and long-term expectations still stable. FOMC also acknowledged that the "strains in global financial markets have eased somewhat," there are still downside risks to growth.

Overall, today's FOMC statement does not change our outlook for possible slowing of asset purchases by mid-2013. Recent data have not been strong enough to shift FOMC policy decisions one way or the other, but we will see another two employment reports before the next meeting that have the potential to encourage a quicker end to QE3. The meeting minutes will likely provide more details on the specific timing for slowing or stopping purchases, but we expect that views have not changed much from December. It is interesting to note that there was no mention of policy uncertainty or the fiscal situation after such topics dominated the discussions toward the end of 2012. While we may see more details in the meeting minutes as to whether or not the January 1st deal in Congress was worse than what the committee had been expecting, the lack of mention in the statement is a sign that the committee is satisfied for the time being and that they will not be reactionary when it comes to fiscal concerns.