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Fed Watch

US

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Economic Analysis

US

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FOMC Statement: March 19-20th

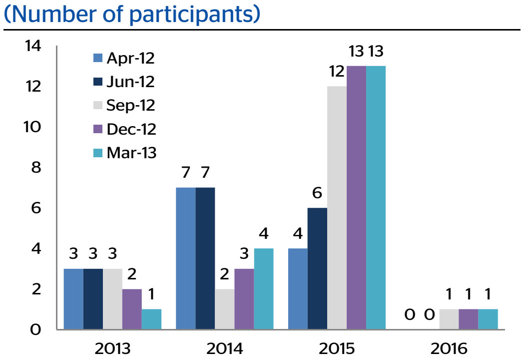
Continued Policy Guidance Balanced By Attention to Indicators

- **Despite evidence of labor market improvements, the Fed remains committed to current asset purchases**
- **Fed forecasts underscore "return to moderate growth following a pause late last year": unemployment rate forecasts down, GDP slightly lower**
- **FOMC remains confident that the benefits of QE still outweigh the risks, although the minutes, released in two weeks, will provide more clarity.**

The FOMC statement, released today, reaffirmed the FOMC's commitment to asset purchases of $40bn in mortgage-backed securities (MBS) and $45bn in long-term treasuries, and target rate of 0.0% and 0.25%. FOMC will also maintain its existing policy of reinvesting principal payments from its holdings and of rolling over maturing Treasury securities at auction. The statement did underscore a tinge of optimism. Of note, the committee highlighted "further" improvements in the housing market, "signs" of improvements in the labor market and reinforced their belief that, while slightly lower than expected, inflation was influenced by transitory factors in energy prices and remained well-anchored. The statement did, however, note that fiscal policy may have become "somewhat" more restrictive since the last meeting and thus was providing negative impetus for growth. In total, the statement was little changed since January, with only a slight change in the communication due to "moderate economic growth following a pause late last year". 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.

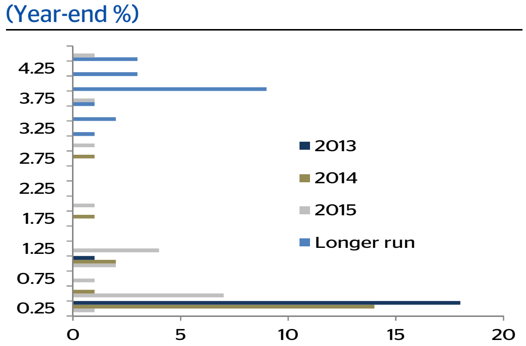
In regard to the committee's forecasts, their outlook on the economy remains mostly unchanged, from December. The FOMC expects growth to pick-up in 2013 albeit at a slower pace than forecasted in December. In addition, the projections anticipate that growth will gain momentum in 2014 and 2015 and converge to long run growth rates of 2.3%-2.5%. The committee also revised down their 2014 forecast for the unemployment rate.

Chart 1
Appropriate Timing of Policy Firming (Number of participants)



Source: Federal Reserve & BBVA Research

Chart 2
Target Federal Funds Rate Forecast (Year-end %)



Source: Federal Reserve & BBVA Research

Supporting the revisions, the Chairman pointed out in the press conference that the labor market was showing signs of improvement but that he is looking for sustainable growth in payrolls and employment, saying 2-3 months of better reports "...just doesn't cut it" for adjusting policy. The housing market also remains a strong facet of the recovery according to Chairman Bernanke and the FOMC, aiding in the growth of consumer activity and business investment. Chairman Bernanke also pointed out in his press conference that the recent home price appreciation has benefited many of the borrowers whose mortgages were underwater.

During the press conference, Chairman Bernanke also addressed some of the headwinds facing the recovery. For example, the March statement included an additional message that "...fiscal policy has become more restrictive." This is most likely a reference to sequestration that took effect late in February. Also, during the press conference the topic of excessive financial risk-taking or the "search-for-yields" in the context of asset purchases came up. The Chairman reiterated, however, that while there were financial risks associated with QE, current market indicators did not suggest that markets were over-heating.

With regard to the committee's outlook on policy timing and rate changes, there was little shift from December's votes to signal an overall change in sentiment. On timing, there was only one vote that shifted, from 2013 to 2014, and thus consensus remains that policy firming will occur in 2015. The committee forecasts showed a shift toward continued low rates in 2014, and suggested that the first rate hikes will not occur until 2015. The distribution of appropriate pace of policy firming shifted towards lower interest rates. In other words, the largest number of participants shifted their belief in the correct time of policy firming from 1% to 0.5% in 2015.

Bottom line: Asset Purchases Will Continue as Planned but Conditions Seem To Be Improving

Today's statement confirmed our belief that open-ended asset purchases will continue into 2h13 although the tone within the statement improved slightly from January. For example, the Fed highlighted the recent increase in employment and continued housing market growth as bright spots for the beginning of the year. Reflecting this, the FOMC projections for the unemployment rate are slightly lower for 2013 and 2014. Given limited revisions to the committee's projections there is little evidence to suggest that policy-firming will occur before 2015. Moreover, the fact that the committee's forecast for the unemployment reaches 6.5% in 2015 reinforces our baseline of no policy-firming before 2015. Overall the situation has remained unchanged since January despite improved economic conditions, signalling that the recovery has gained momentum. Ultimately, the FOMC needs to see more sustained improvements before they reassess or adjusts their guidance.

Table 1
Federal Reserve Forecast Comparison: March 20th FOMC Statement and Press Conference (Central Tendency)

	March 2013 FOMC Projections					Dec 2012 FOMC Projections			
	2013	2014	2015	Long-term		2013	2014	2015	Long-term
	GDP, 4Q yoy % change					GDP, 4Q yoy % change			
Low	2.3	2.9	2.9	2.3	Low	2.3	3.0	3.0	2.3
High	2.8	3.4	3.7	2.5	High	3.0	3.5	3.7	2.5
	Unemployment rate, 4Q %					Unemployment rate, 4Q %			
Low	7.3	6.7	6.0	5.2	Low	7.4	6.8	6.0	5.2
High	7.5	7.0	6.5	6.0	High	7.7	7.3	6.6	6.0
	Core PCE, 4Q yoy % change					Core PCE, 4Q yoy % change			
Low	1.3	1.5	1.7	2.0	Low	1.6	1.6	1.8	---
High	1.7	2.0	2.0	2.0	High	1.9	2.0	2.0	---

Source: Federal Reserve & BBVA Research