BBVA

Fed Watch

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FOMC Minutes June 23-24, 2009

- **Economic activity has stabilized further, but risks remain**
- **Core inflation is expected to remain low**
- **Committee will maintain the target rate of 0 to 0.25%**

The FOMC announced that economic contraction had subsided and downside risks to economic growth had diminished, but threats remain. Participants also judged that financial market developments have been positive, but could be attributed to support from government programs rather than solid fundamentals, and credit markets remain tight amid worsening credit quality.

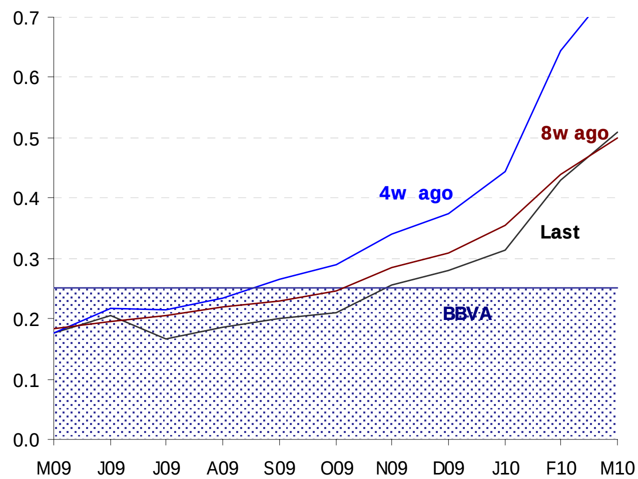
Staff again revised up its forecasts for 2H09 and 2010 amid some stabilization in consumer spending, flattening out of new home sales and starts and lesser declines in capital spending than the previous quarter. They now expect real GDP growth in 2010 to surpass the growth rate of potential GDP and for the unemployment rate to rise further in 2009, but creep downward in 2010. Although members agreed that conditions have improved, they cited that falling employment, lower household wealth, tight credit conditions, elevated savings rate and future declines in personal income could pose risks to consumer spending. Furthermore, ongoing foreclosures could push housing prices down further. In addition, labor market weakness was of particular concern, especially the rise in the participation rate, which could indicate that more people are entering the workforce out of economic necessity. Lastly, members viewed that exports would not contribute to the country's recovery as the global nature of the recession has inhibited worldwide demand for US goods.

The committee continues to believe that core inflation could remain low for a prolonged period of time, but downside risks have lessened. Nevertheless, there is still considerable economic slack in the economy and the mounting unemployment, along with expectation of future job losses, has slowed the increase in labor compensation. Accordingly, the FOMC deemed that it will maintain the target for the federal funds rate at 0 to 0.25%.

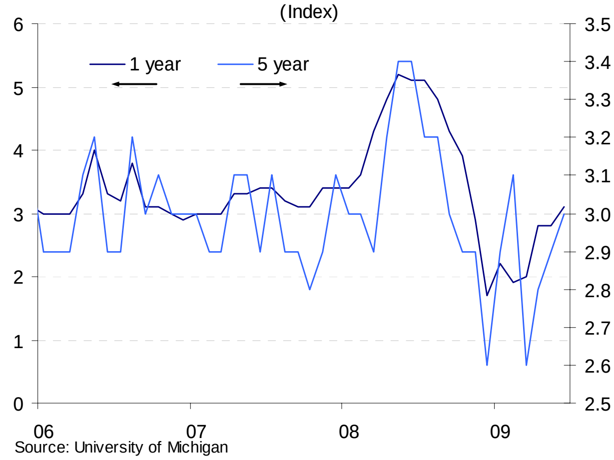
Bottom-line: Although the committee stated that economic conditions have improved, the minutes suggest that they are closely monitoring the many risk factors in the economy. Nevertheless, their future outlook is more positive than it was previously, which is supported by the announcement that the *"asset purchase programs should proceed for now on the schedule announced at previous meetings."* Given the proceedings of the meeting, we expect the Fed to hold the fed funds rate low for a prolonged period of time.

Fed Funds: 0 to 0.25%
Next Meeting: August 11-12
Minutes Release: September 2

Fed Funds Expectations
(Fed Funds futures, end of contract, %)



University of Michigan Inflation Expectations
(Index)



Source: University of Michigan