Economic Research Department

BBVA

U.S.

Fed Watch

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Fed Funds: 0.0-0.25%
Minutes Release: November 25, 2009
Next Meeting: December 15-16, 2009

Fed funds rate will remain low for a prolonged period

- **Target interest rate maintained at 0.0-0.25%**
- **Economic slack justifies holding rates low as recovery begins**
- **FOMC economic outlook improved but challenges remain**

The primary take-away from the FOMC's statement is that it will likely continue to hold the fed funds rate at a low level for a prolonged period of time even as the recovery takes hold. While the statement maintained the language stating that, "economic conditions… are likely to warrant exceptionally low levels of the federal funds rate for an extended period," it elaborated economic conditions to include, "low rates of resource utilization, subdued inflation trends, and stable inflation expectations." This addition sends the message to markets that the committee will most likely wait until economic growth is clearly sustainable before raising rates.

Although the FOMC believes economic slack to be abundant, its economic outlook has improved since the previous statement. The strongest shift was in the committee's message on household spending. While the four previous statements implied stabilization in PCE, today's release stated that, "household spending appears to be expanding." Nevertheless, the positive message was balanced by citing the weak labor market, low housing wealth, sluggish income growth and tight credit. These factors could keep consumer spending subdued, which is consistent with our baseline scenario of a slow recovery in consumption.

In terms of monetary policy, the statement does not indicate how or when the Fed will begin the exit process. The committee did announce that it will purchase $175 billion of agency debt, which is below the allotted $200 billion, due to the "limited availability of agency debt." This decision was most likely driven by market factors. The statement also stressed that this target is, "consistent with the recent path of purchases," indicating that it is not deviating from current policy. Furthermore, the committee's outlook that, "inflation will remain subdued for some time," remained the same.

Bottom-line: Today's statement sent the message that the Fed will be wary of removing economic stimulus too early. While the committee's outlook is more positive, it also acknowledged that challenges remain, indicating that there is a degree of uncertainty in the recovery's path. This view is in line with our baseline scenario for 2010, which expects recovery to be slow, predominately due to subdued consumer spending. Given the results of the FOMC meeting and our future expectations, we maintain our forecast of low interest rates for a prolonged period of time.