BBVA Research

U.S.

Fed Watch

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Economic Analysis

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FOMC Minutes: March 15

Elevated discussion of the degree of accommodative stance

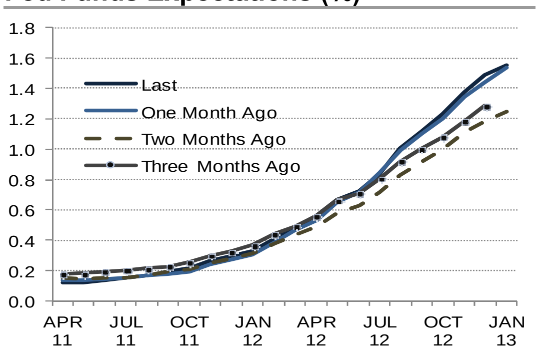
- **FOMC members see inflation risks tilted to the upside; oil price increases transitory**
- **Growth projections are "roughly balanced" amidst an economy "gaining traction"**
- **The Fed decides that tapering treasury securities is unnecessary**

Today's release of the FOMC minutes reveals that the Federal Reserve will not taper its purchases of treasury securities towards the end of its current large-scale asset purchase program. The central bank believes the depth and liquidity of the treasury market precludes the necessity of tapering as a method of avoiding financial dislocations. Federal Reserve staff members see the economy as "gaining traction," specifically in the areas of improved labor market conditions and growth continuing at a moderate pace. However, pressures on the economy remain from a depressed housing sector and recent increases in commodity prices. FOMC members regard these recent commodity increases as largely transitory. Participants view measures of underlying inflation as subdued, but "bottoming out" compared to historical data. Resource slack will continue to restrain labor costs, although some members questioned the predictive power of slack measures. Staff economists reported that market measures and survey indicators of long-term inflation expectations remained stable. In general, FOMC members are biased towards upside risks for their inflation forecasts. This stems from uncertainty over the duration of commodity price increases and also the current degree of pass-through from energy to core inflation indices. A few FOMC members were prompted by this discussion to note that a numerical inflation target would help solidify these expectations.

Although the committee now views inflation risks as tilted to the upside, the outlook for economic growth is more balanced. This is the result of a number of competing domestic and international factors. For example, FOMC members still view downside risks from geopolitical strife, fiscal and banking consolidation in Europe, a depressed housing market, and US fiscal reform at the state and Federal level. Alternatively, FOMC members view upside risks from acceleration in hiring, higher consumer spending, and more robust business investment. The text of the minutes suggest more heightened discussion of the accommodation stance, with some members viewing current data as warranting less accommodation, while a few other members' view of the data supports accommodation beyond 2011. Today's minutes confirm our baseline scenario that QE2 will be implemented as planned and that there will be no rate hike in 2011.

Chart 1

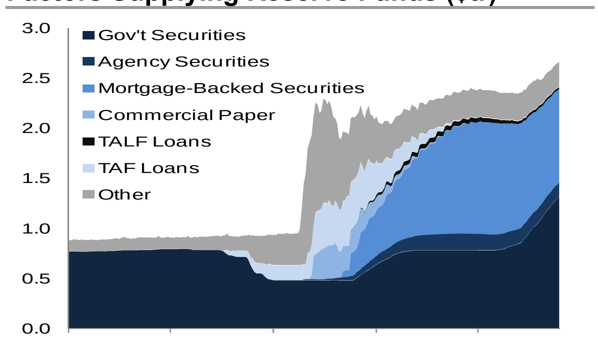
Fed Funds Expectations (%)



Source: BBVA Research and Bloomberg

Chart 2

Factors Supplying Reserve Funds ($tr)



Source: BBVA Research and Federal Reserve

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