RESEARCH

Fed Watch

US

9 August 2011
Economic Analysis

US

Hakan Danış
hakan.danis@bbvacompass.com

Jeffrey Owen Herzog
jeff.herzog@bbvacompass.com

FOMC Statement: August 9

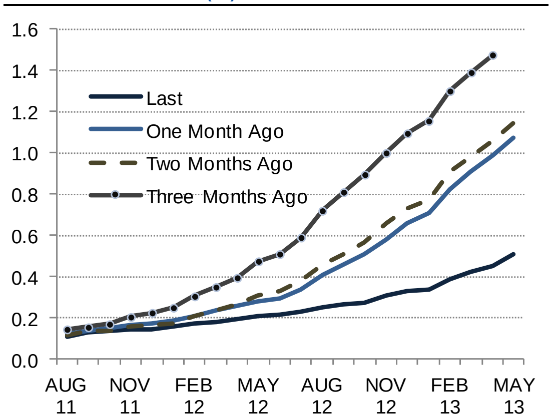
Transitory factors no longer to blame

- FOMC says exceptionally low levels for fed funds rate until mid-2013
- Fed downgrades its forecast for economic activity and sees inflation at bay
- No third round of quantitative easing

Three FOMC members dissent

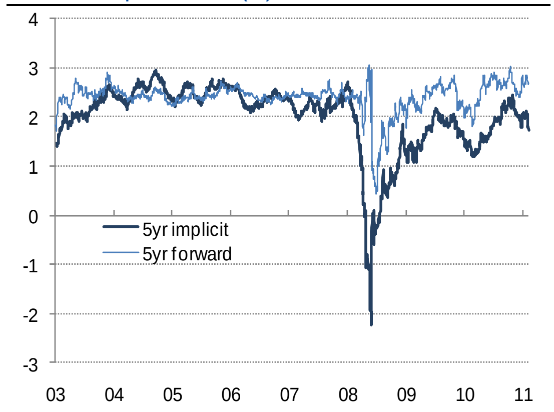
Prior to today's FOMC statement, the US suffered through a rancorous debt ceiling debate, a major revision to GDP by the BEA, a downgrade of the US credit rating, continuing European sovereign debt issues, and yet another lackluster nonfarm payroll number. Given all this information, the Federal Reserve downgraded their assessment of growth and now see downside risks as having increased. With regard to inflation, the FOMC expects inflation pressures to be limited and will stay at or below its implicit inflation target. The FOMC believes that the recent slowdown in economic activity is only partly explained by temporary factors, a major contrast to their previous statements which emphasized a better second half for the US after temporary factors dissipated. If we make a simple assumption that the FOMC's estimate of long-run potential growth remains constant, today's statement reveals that the Fed believes excess resource slack will persist for longer than previously estimated. As a result, the FOMC decided to tweak the wording of what is often called its extended period language to read "exceptionally low levels for the federal funds rate at least through mid-2013." This is the most the Fed could instigate given the state of economic growth and inflation at the present time. At the very least, the Fed is hoping to reduce interest rate volatility to streamline business conditions slightly for pro-growth purposes. The key insight to the statement is the phrasing "currently anticipates": given different data, the Fed may anticipate something different at a later meeting. As such, we do not view the new guidance as 100 percent ironclad. Importantly, three FOMC members dissented to today's announcement, which underscores the degree of uncertainty within the FOMC over the economic outlook.

Chart 1
Fed Funds Futures (%)



Source: BBVA Research and Bloomberg

Chart 2
Inflation Expectations (%)



Source: BBVA Research and Haver