

Fed Watch

US

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Economic Analysis

US

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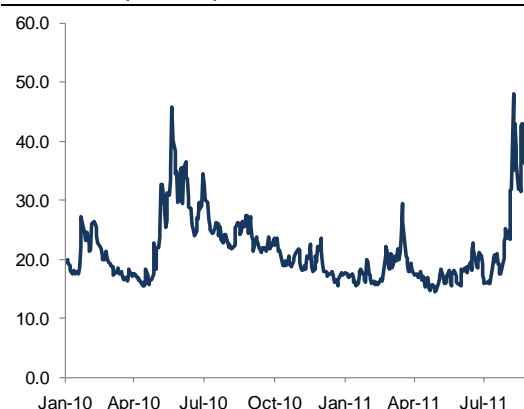
Jackson Hole Speech: August 26 All Eyes on the September Meeting

- The pace of the recovery has proven “disappointing” so far
- Fiscal policy reform is needed to support long-run growth
- Next meeting extended to fully discuss additional stimulus

Bernanke Portrays Positive View of the US's Fundamental Qualities

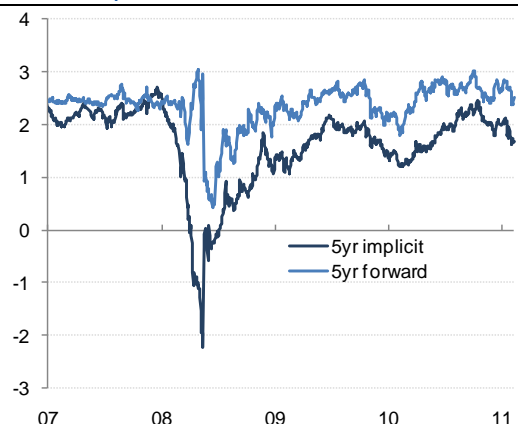
Today Federal Reserve Chairman Ben Bernanke delivered a largely safe speech outlining the important reforms that must take place to ensure a strong long-term US growth potential in the future. The Chairman did not elaborate extensively on monetary policy, though he did say that considerable discussion over the state of the economy is needed for the September meeting. One major take away from this speech is that Tuesday's release of the FOMC minutes will be very informative of which policy tools are under consideration. In our view, the probability of more stimulus has slightly increased, but it remains strongly contingent on how economic indicators evolve over the next few months. Today's dilemma facing the Fed is different from last year's high deflation risk. While economic conditions are lackluster, a clear need for stimulus has yet to be established. If the Fed's risk scenario emerges, we believe the Fed will act. This would involve one or more of the following: a slower than expected 2011H2, financial market instability, contagion from European sovereign debt, or deflation risk. In Bernanke's view, the long-term performance of the economy depends on reforms by Congress. If these reforms cannot be implemented – control of health care costs, fiscal consolidation, measures to improve competitiveness – then US growth in the long run will disappoint. In the long term, the Fed can aid this process only through financial regulation and low and stable inflation. Bernanke is positive on the long-run, but he revised down his forecast for the short term. Bernanke did not reveal his bias towards more or less monetary stimulus, but the decision will be made in the next FOMC meeting in September.

Chart 1
VIX and Corporate Spreads



Source: BBVA Research and Bloomberg

Chart 2
Inflation Expectations (%)



Source: BBVA Research and Haver

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