RESEARCH

Fed Watch

US

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Economic Analysis

US
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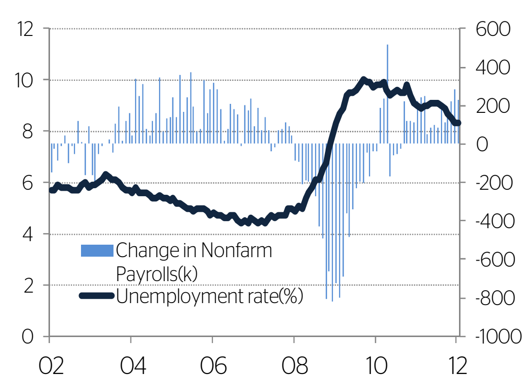
FOMC Minutes: March 13

- Economic outlook broadly similar to January meeting
- A “nonnegligible” risk that employment could deteriorate is still present
- Recent inflation increase is temporary and expected to return to target

Data improves, but growth is not yet at a strong enough pace and faces downside risks

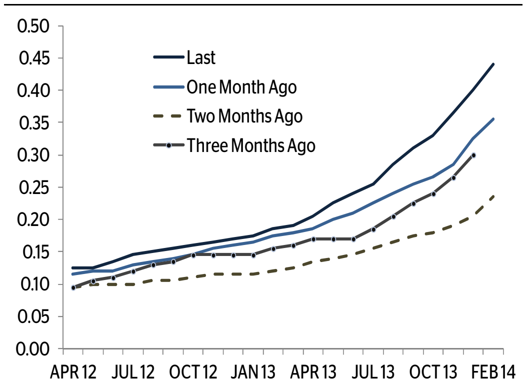
The major message from the minutes is that the FOMC's growth outlook is little changed from January, with selected marginal improvement in some indicators. However, given "continuing headwinds" and the still-present risk that conditions may slow down as in 2011, the FOMC sees little need to change stance at the present time. The recent increase in inflation will limit their efforts to support the economy. In particular, the minutes have been recurrently discussing the exact size of the output gap and its implication for the inflation forecast. The problem is that the forward behavior of inflation is contingent on too many uncertain factors. Unseasonably warm weather and the decline in natural gas prices may have limited the impact of high oil prices on headline inflation. Despite these concerns, the FOMC is steadfast in their assertion that they expect inflation to be at or below their mandate and that the recent increase in inflation is temporary. The discussion of the labour market in the minutes is nearly identical to Chairman Bernanke’s recent speech on the matter. His sentiments were that although labour market indicators have improved, we cannot be sure they are sustainable at the present time. In particular, Bernanke would like to see stronger openings and more churn in the labour market before becoming more positive on the longer-run outlook. One issue that is becoming louder in the minutes is the fiscal drag to occur in 2013 if no long-term budget deal is reached in Congress. Although the Federal Reserve has mentioned the prospect of fiscal drag in previous speeches and communications, the statement in the minutes is phrased somewhat more boldly in that it directly addresses the lack of a fiscal deal as a potential risk to growth in the medium-term (“abrupt and sharp” terminology). The other downside risks to the outlook are Europe’s continuing sovereign debt issues, slower growth in the world economy, a depressed housing market, further household deleveraging and high levels of uncertainty. In summary, the minutes have not changed our baseline scenario of no rate hike in 2012 and 2013.

Chart 1
Nonfarm Payroll and Unemployment Rate



Source: Haver Analytics & BBVA Research

Chart 2
Fed Funds Futures



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