U.S. Flash

FOMC Preview: April 24-25
The Waiting is the Hardest Part

- We expect a wait-and-see attitude until a clear direction emerges in the data
- FOMC to evaluate progress of new communication, release of forecasts
- The Fed will not significantly revise their outlook or statement

The Federal Reserve over its two-day meeting this week will adopt in general a wait-and-see attitude that will continue until a clear direction emerges in the economic data. To one wing of the FOMC, the economic crisis has caused a downward shift in the economic potential of the US and monetary policy now must be less accommodative in order to ensure inflation remains close to the Fed's mandate. To another wing of the FOMC, a string of improved economic data over the prior three months will falter over the next several months and monetary policy must be more aggressive in ensuring a sustainable recovery. On both sides of the policy debate exists a tinge of self-doubt. Creeping behind the academic debate of monetary policy at the zero bound and the close analysis of whether economic indicators are flashing a true signal despite seasonal issues is another kind of uncertainty. What is unknown to the Fed in addition to all the other uncertainties is the long-term effect of extraordinary or unusual monetary policy measures. It is entirely possible that all the extraordinary balance sheet measures may be properly unwound at the appropriate time. Moreover, it is also possible that monetary policy has for too long substituted for actions by governments and functioning capital markets and this may lead to unintended consequences.

Self-doubt, however, is a luxury the Federal Reserve can afford only after it has resolved the questions of the present. In particular, speeches and comments over the intermeeting period suggest that the Federal Reserve during its two day meeting will take a closer look at the trajectory of the labor market and its implications for inflation, the relationship between growth and employment, and excess resource slack. FOMC members will also evaluate the effectiveness of new communication tools. For example, the Federal Reserve is sure to chart the progress of market expectations for Fed Funds futures versus the published FOMC forecasts. Participants will also discuss how market participants have absorbed the two percent target.

Data to arrive over the next two weeks will be crucial to the Fed's discussion in three ways, although only some of the data will be available for the meeting itself. First, consumption and investment will be characterized via durable goods orders and personal income and outlays. Second, the continuing uncertainty over the strength of hiring will be detailed via the nonfarm payroll. Lastly, and most importantly, the Fed will likely have some advance word on the 2012Q1 GDP release. FOMC participants will use the available data to game out different potential scenarios for the year such as: higher than expected inflation, financial instability from Europe, and economic growth at the lower end of FOMC projections. These different scenarios will be related to different policy options available to the FOMC, such as further balance sheet expansion or communication.

Bottom line: Plenty to gnash teeth about

The end result, however, of all this discussion will be a continued wait-and-see attitude. We do not expect the Federal Reserve to significantly revise their forecasts or outlook as a result of this meeting. Our own forecast is for continued sluggish growth and disappointing hiring, justifying a highly accommodative monetary policy stance. The pace of growth does not yet warrant additional asset purchases, but the economy is not yet self-sustaining. As such, the current state of the economy is well-placed to seed doubts in the minds of central bankers as their thoughts grind on a position one way or the other on accommodation.

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