RESEARCH

Fed Watch

US

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Economic Analysis

US
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FOMC Statement: April 24-25

A slightly more centrist FOMC with lower QE probability

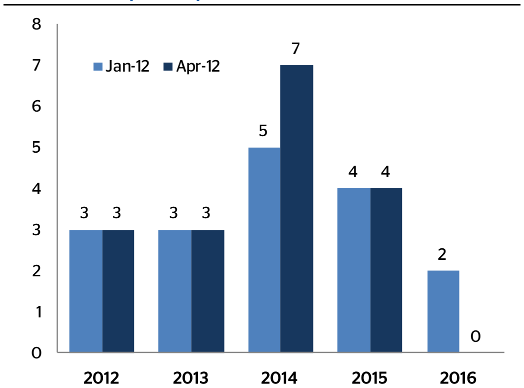
- **Operation Twist to end as scheduled**
- **FOMC upgrades 2012 growth, but risks to outlook remain high**
- **Two participants back away from 2016 tightening estimate**

Sifting through today's statement, forecasts and press conference

The Federal Reserve today upgraded their 2012 GDP forecast, but downgraded their 2013 and 2014 GDP forecast. Given recent increases in commodity prices, the Federal Reserve also increased their outlook for inflation, but over the year expect inflation to reside at or below their long-run inflation target. The Federal Reserve will also maintain its existing policy of reinvesting principal and lengthening the average maturity of its holdings of securities. Given ongoing risks to the outlook (for example, European sovereign debt issues) and persistent drags on growth (for example, US fiscal consolidation and a depressed housing sector), conditions still warrant low interest rates for a long period of time. Notably missing from today's press conference and statement was any qualitative guidance on the size of the balance sheet. Most likely, FOMC members need more time to study the usefulness of supplying this form of communication. Bernanke mentioned that the FOMC is still working on options for streamlining communication to the public of monetary policy aims and actions. Within the overview of FOMC participants' assessments of appropriate monetary policy, the major change today was a retreat of two participants away from a 2016 policy firming. This reveals gravitation towards the centrist view of the FOMC.

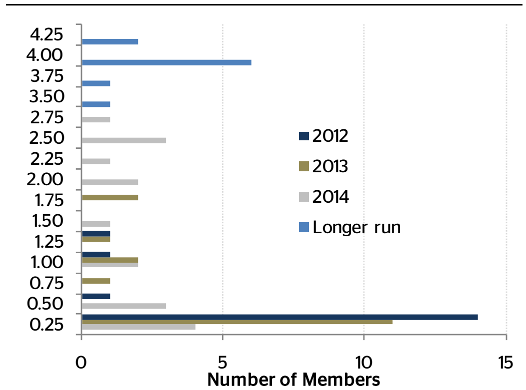
During the press conference, Bernanke did note that the data points representing the target Fed Funds rate at year end are "just inputs into a decision process" that are "uncertain from an individual point of view." Touching on the definition of the word "exceptionally," Bernanke stated that in his personal view this term means a 0-.25% Fed Funds rate, but noted that each FOMC participant may have a differing view. Responding to questions on the labour market, Bernanke stated that given the current trend in labour force participation, the economy needs around 150k to 200k in job creation per month to reduce the unemployment rate. A job creation pace of 100k, according to Bernanke,

Chart 1
Appropriate Timing of Policy Firming (Number of participants)



Source: Federal Reserve & BBVA Research

Chart 2
Target Federal Funds Rate Forecast (Year-end %)



Source: Federal Reserve & BBVA Research

would keep the unemployment rate stable. Another concern of Bernanke is the fiscal outlook of the US starting in 2013. Bernanke continues to stress the need for fiscal reforms and noted a high risk of austerity measures becoming implemented. As such, Bernanke believes that Congress should balance the two goals of fiscal sustainability and economic growth. One of the last topics of the press conference related the experience of Japan to the United States, focusing on the question of whether or not Bernanke's view of monetary policy has changed since he was a university professor. Some of the prescriptions for fighting deflation Bernanke considered in his pre-Chairmanship days were not subsequently used during his tenure as Chairman. In response to this question, Bernanke argued that conditions in Japan were different than the current situation in the United States. For example, Bernanke said that the Federal Reserve has been very aggressive at the onset of the crisis. Furthermore, the Federal Reserve does not need to be extremely aggressive now because the US is not subject to the amount of deflation that Japan experienced. With moderate growth and inflation around the long-term target, there is no need for additional accommodation.

Bottom line: A slightly more centrist FOMC

We expect Operation Twist to end as scheduled. Many FOMC members believe in a portfolio balance theory whereby the stock of assets is more important than the flow of assets, meaning the end of Twist will not strongly affect Treasury yields. Given a "gradual" decline in the unemployment rate and a "pickup" in economic activity, the probability of additional large-scale asset purchases has declined. Naturally, if financial conditions deteriorate or growth is derailed by one of many persistent drags on the economy, quantitative easing remains "on the table" as a policy option. Our expectation remains unchanged for a first Fed Funds rate increase in October 2014.

Table 1
Federal Reserve Forecast Comparison: April 25 FOMC Statement and Press Conference (Central Tendency)

	Jan 2012 FOMC Projections				Apr 2012 FOMC Projections			
	2012	2013	2014	Long-term	2012	2013	2014	Long-term
GDP, 4Q yoy % change								
Low	2.2	2.8	3.3	2.3	2.4	2.7	3.1	2.3
High	2.7	3.2	4.0	2.6	2.9	3.1	3.6	2.6
Unemployment rate, 4Q %								
Low	8.2	7.4	6.7	5.2	7.8	7.3	6.7	5.2
High	8.5	8.1	7.6	6.0	8.0	7.7	7.4	6.0
Core PCE, 4Q yoy % change								
Low	1.5	1.5	1.6	---	1.8	1.7	1.8	---
High	1.8	2.0	2.0	---	2.0	2.0	2.0	---

Source: Federal Reserve & BBVA Research