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Fed Watch

US

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Economic Analysis

US
Boyd Nash-Stacey
boyd.nashstacey@bbvacompass.com

QE Dashboard

New policy guidance reaffirms Fed's commitment

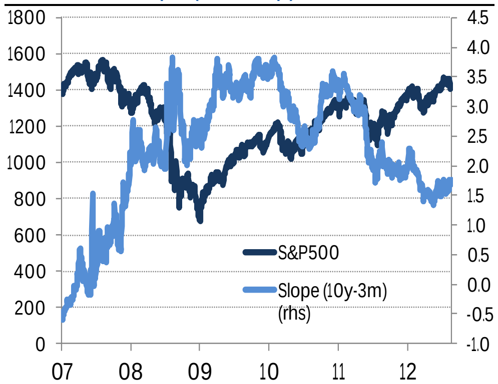
- Unemployment rates and yield curve declines of 0.6pp and 36bp, since the initial announcement of the maturity extension program, were not enough to foster **"sustained improvements in labor conditions"** according to the FOMC
- Low inflation, stable exchange rates and declining commodity prices support high levels of accommodation in the short-to-medium run
- Although credit remains tight, underlying housing market strengths could create medium-to-long run impetus for tightening if reserve outflows are mismanaged
- The reaffirmed commitment to markets comes with 5-yr forward inflation expectations edging above the newly minted tolerance of no more than 50bp higher than the 2% target, suggesting that the Fed remains willing to tolerate slightly higher long-run inflation risks

Table 1
Large Scale Asset Purchases (LSAP) Scorecard

	QE3 (Hybrid) Latest available	Sterilized Purchases 10/11-12/12	Post QE2 11/10-10/11	Recovery 7/09-10/10	Crisis 12/07-6/09	Pre-Crisis 3/03-11/07
Inflation Indicators						
Slope (bp)	168	204	284	321	243	139
10yr Treasury (%)	1.7	2.1	2.9	3.3	3.5	4.4
10yr Inflation Indexed (%)	-0.7	-0.1	0.8	1.3	1.8	2.1
5yr breakeven inflation expectations (%)	2.1	1.9	1.8	1.6	1.3	2.3
5yr forward inflation expectations (%)	2.8	2.5	2.5	2.4	2.1	2.4
CRB Spot Commodity Prices(Index,1967=100)	486	506	519	421	392	316
West Texas Intermidiate Spot Price($)	86.8	94.7	89.2	75.8	82.9	53.2
Consumer Prices (12m %)	1.7	2.4	3.0	1.4	2.0	3.6
Core Consumer Prices (12m %)	1.6	2.2	1.5	1.5	2.0	2.4
Risk Indicators						
VIX (Index)	16.0	22.5	22.3	23.7	33.6	15.8
S&P500 (Index)	1419	1310	1226	1093	1109	1219
FTSE Emerging Markets	730	706	773	682	599	868
US Dollar (Effective, broad Index)	99.2	98.8	98.2	102.3	102.8	111.2
US Dollar (Effective, emerging markets)	127.0	127.5	126.6	131.8	130.7	138.4
Corporate Spreads (BAA bp)	294	313	288	287	106	302
3M Libor-Treasury (bp)	24	36	22	22	243	139
Growth Indicators						
Intial Claims (4wk avg)	382	378	418	493	479	332
Unemployment rate (%)	7.7	8.3	9.1	9.7	6.8	4.7
Private Payrolls (K monthly)	147	155	167	-7	-396	75
Consumer confidence (Index)	74	63	58	53	53	88
Housing Starts	894	710	572	588	781	1818
Core Logic Home Prices (yoy%)	6.3	0.1	-4.4	-2.4	-14.1	9.0
Retail sales ex bldg, autos & gas (yoy %)	3.6	5.2	5.8	0.9	-0.6	5.3
Industrial production (yoy %)	1.8	4.1	4.4	0.2	-7.0	2.3
ISM Survey (Index)	49.5	52.2	55.9	55.9	43.9	54.1
Credit Markets						
Monetary aggregate M1 (yoy %)	13.3	9.0	6.0	3.9	7.6	5.5
Bank Credit ($bn)	6141	6018	5870	5967	6081	4520
Bank Mortgage loans ($bn)	2124	2104	2073	2107	2057	2011
Commercial Paper issuance ($bn)	64	80	86	88	134	174
30yr Mortgage sprd (bp)	55	84	39	57	155	115
CP 3m spread (bp)	11	14	14	15	95	24

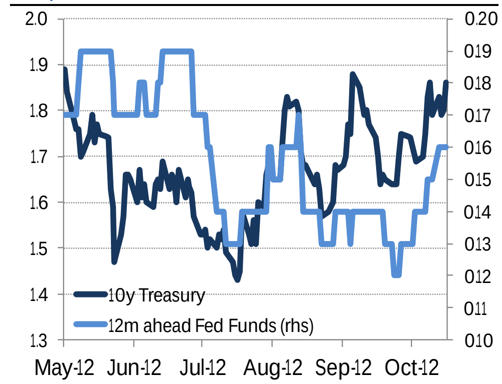
BBVA Research & Haver Analytics. * Pre-Crisis = Nov 2007

Chart 1
S &P 500 & Slope (Index,bp)



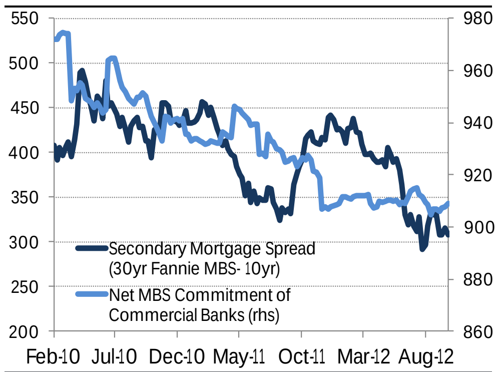
Source: Bloomberg, Haver Analytics & BBVA Research

Chart 2
10year Treasury & Fed Funds futures, (yields & %)



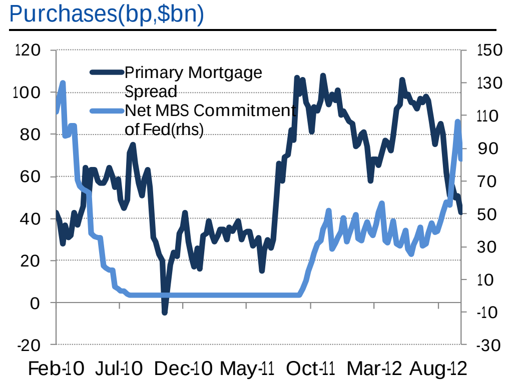
Source: Haver Analytics & BBVA Research

Chart 3
Secondary MBS Spread & Net Commercial Bank MBS Commitment



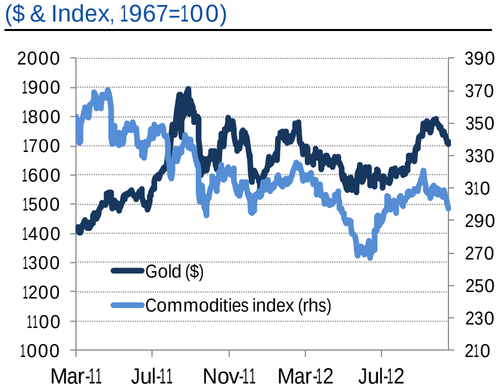
Source: Haver Analytics & BBVA Research

Chart 4
30yr Mortgage Spread & Net Fed MBS Purchases(bp,$bn)



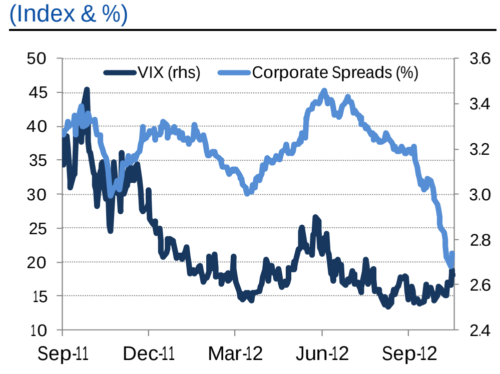
Source: Haver Analytics & BBVA Research

Chart 5
Gold & Commodities
($ & Index, 1967=100)



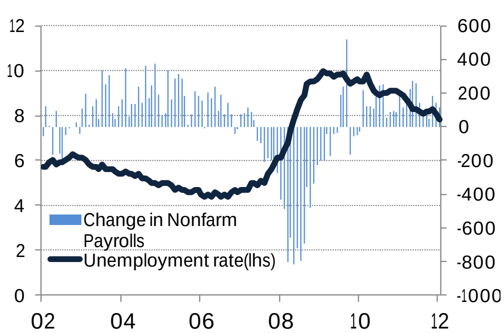
Source: Haver Analytics & BBVA Research

Chart 6
Implied Volatility & Corporate Spreads
(Index & %)



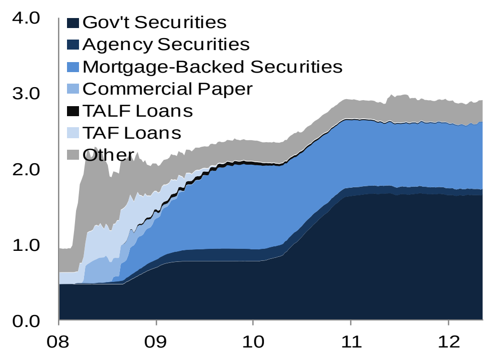
Source: Haver Analytics & BBVA Research

Chart 7
Unemployment & Nonfarm Payrolls (%&K)



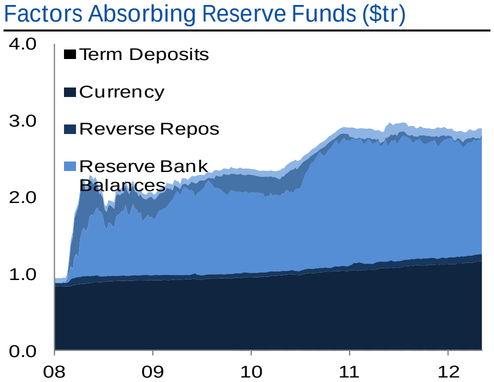
Source: Haver Analytics & BBVA Research

Chart 8
Factors Supplying Reserve Funds ($tr)



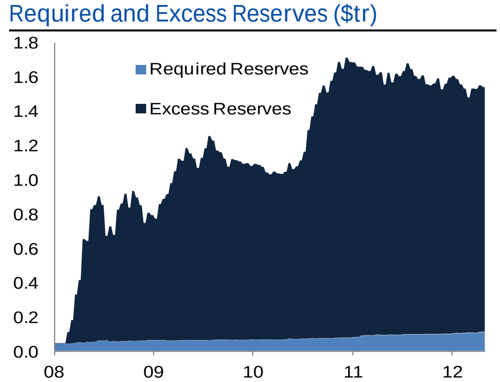
Source: Haver Analytics & BBVA Research

Chart 9
Factors Absorbing Reserve Funds ($tr)



Source: Haver Analytics & BBVA Research

Chart 10
Required and Excess Reserves ($tr)



Source: Haver Analytics & BBVA Research

Bottom line: Slight improvements not enough to reduce Fed accommodation

The announcement of additional Quantitative Easing this past week coincided with broader improvements in many key indicators such as unemployment and a reduction yield curve slope, which decreased 0.6pp and 36bp, respectively. These fundamental improvements and the underlying housing market rebound were not enough to reduce the amount of stimulus or timing of Fed withdrawal. Rather, the Fed enhanced its commitment to high levels of accommodation, tying the commitment to substantial reduction (1.2pp) of unemployment rate. In addition, in the short-run, risks appear balanced between high levels of liquidity and slow growth and limited inflationary pressures, which are below the explicit long-run inflation target of 2.0% plus a 50bp buffer.

However, continued accommodation is not costless. For example, forward—greater than 5yr—inflation expectations suggest upside risk to long-run inflation. Moreover, extremely high levels of bank reserves could increase inflationary pressures if the outflow of reserves was not carefully controlled or directed at unstable market such as residential mortgages. Given that risks appear tilted to the long-run and the Fed has now firmly committed to labor market improvements, we do not anticipate any change from the current levels of accommodation in the foreseeable future.