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Fed Watch

US

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Economic Analysis

US

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FOMC Statement: April 30th – May 1st

FOMC Conveys Elevated Level of Readiness to Tune QE to Change in Economic Conditions

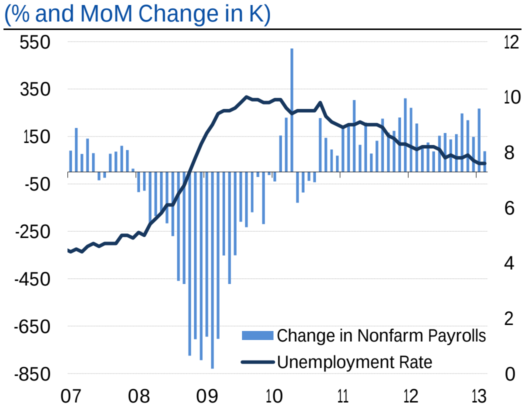
- The pace of asset purchases was left unchanged, as is our projection for the QE3 path
- FOMC hinted on the possibility of dialing up purchases if 'the outlook for the labor market or inflation changes'
- Announcement is silent on Committee's assessment of the present downward pressure on inflation

The newly released FOMC meeting announcement was in line with our expectation on maintaining the current pace of $85bn per month in asset purchases (Ahead of April 30 – May 1). The committee announced that they agreed to continue purchasing $40bn per month in mortgage-back-securities (MBS) and $45bn in longer-term Treasury securities, as well as reinvesting principle payments into MBS and rolling over maturing Treasury securities at auction. The FOMC will continue on-going purchases while closely monitoring the efficacy and cost of these actions. Furthermore, the FOMC stated that:

"The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes."

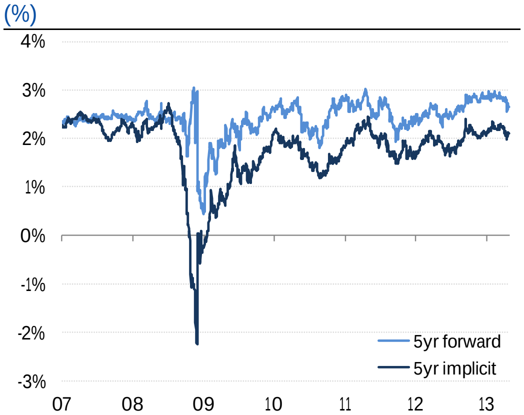
The following new addition to the statement communicates the level of readiness for the Committee members to face weaker than expected labor market data. FOMC's outlook on labor market conditions changed from stating that the labor market shows 'signs of improvement' to 'some improvement,' 'on balance.' Additionally, a noteworthy change in the economic outlook of the statement is the assessment of the direct impact of fiscal policy on the recent softer economic data. The statement regards fiscal policy as 'restraining economic growth' in contrast to the prior characterization as 'somewhat more restrictive.'

Chart 1
Unemployment Rate and Nonfarm Payrolls
(% and MoM Change in K)



Source: FRB, Bureau of Labor Statistics, & BBVA Research

Chart 2
Inflation Expectations
(%)

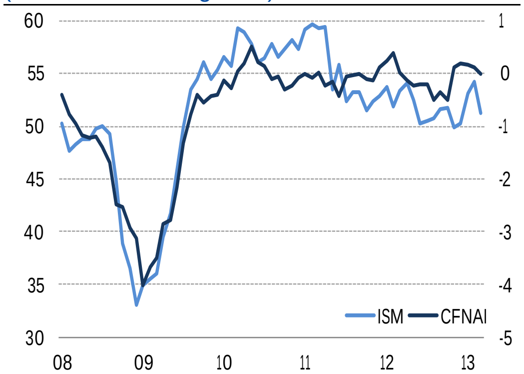


Source: Federal Reserve & BBVA Research

What the announcement did not disclose is the Committee's view on the present downward pressure on the inflation rate that was observed in the recent sliding of headline and core PCE, in the weakness in commodity prices, and in this week's Dollar retreat. The Committee continues to view the inflation rate as 'running somewhat below the Committee's longer-run objective' and the longer-term inflation expectations as well-anchored. We expect to learn more on the Committee's outlook on inflation with the release of the minutes.

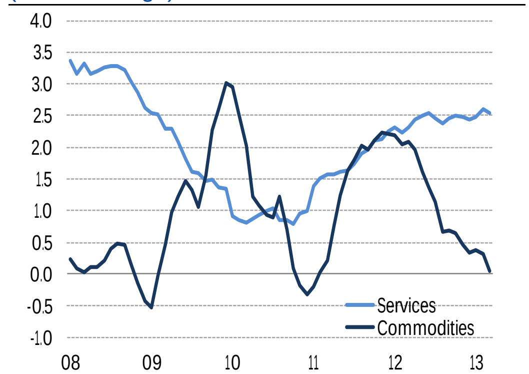
The single vote against the action came from Esther George of the Kansas City Federal Reserve, whose hawkish stance remains unchanged. George remains concerned that continuing accommodation could cause future imbalances and an increase in long-term inflation expectations. We expect that the April 30 – May 1 meeting minutes will reveal the Committee's shift in the debate from tapering of purchases towards the possibility of an increase in monthly purchases. At the same time, we do not believe these debates will materialize in action unless we observe a continued weakening of labor market indicators and the risk of an increase in the unemployment rate.

Chart 3
ISM Manufacturing, Chicago Fed NAI
(50+ and 3m average, rhs)



Source: ISM, Chicago Fed, & BBVA Research

Chart 4
CPI: Services and Commodities
(YoY % Change)



Source: Bureau of Labor Statistics & BBVA Research

Bottom line: Our projection for QE3 remains unchanged, with no change in the pace of asset purchases until 3Q13

There are no changes in the pace or composition of asset purchases. We maintain our projection that the current pace of purchases will continue until 3Q13. We expect FOMC discussion on tapering QE and the exit strategy to be postponed awaiting for the return of 'signs of improvement' in the labor market and an uptick in the inflation indicators. As we stated on April 19th (Ahead of April 30 – May 1): Committee members are watchful of substantial improvements in the labor market outlook and are prepared to dial down the pace of QE3 if they detect any evidence of improved economic momentum or overheating of credit markets. However the FOMC is also ready to dial up the pace of QE3 if the negative impact of fiscal policy turns out to be stronger than expected.