



# Fed Watch

December 16, 2009

## FOMC December 16<sup>th</sup> 2009

- Economic and financial conditions improve
- Fed maintains its outlook of low inflation
- In this environment, Fed funds are likely to remain low for a prolonged period

As in previous statements, FOMC members consider that “economic activity is likely to remain weak for a time”. However, Fed continues to improve its assessment on the economic outlook and made three major changes to the economic activity paragraph in its latest statement. The first one indicates that “Financial market conditions have become more supportive of economic growth”. The second one highlights better prospects for employment as “deterioration in the labor market is abating”.

In addition Fed replaced the reference that businesses are still cutting back on staffing with the view they remain reluctant to add to payrolls. This suggests that FOMC expects payroll to stabilize soon although not to necessarily increase. The third one reflects an improvement in income growth trends from “sluggish” to “modest”. These changes imply that the Fed has a more positive outlook for household spending.

The FOMC assessment on inflation remained unchanged. It continues to signal that “With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.”

Fed maintained its perspective that “economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.” In addition, the FOMC used the statement to remind the public of the previously scheduled expiration dates of different liquidity programs, indicating that financial market trends are in line with previous expectations.

**Bottom-line:** Stronger financial conditions guarantee that Fed will implement its exit strategy as planned. Moreover, the improvement in the Fed’s economic outlook is in line with our baseline scenario of a gradual economic recovery and low inflation. Thus we maintain our expectation of low interest rates for several more quarters.

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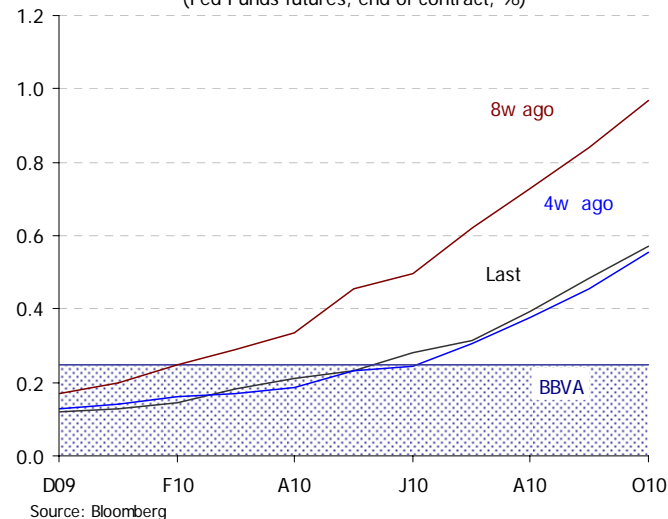
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**Fed Funds: 0% to 0.25%**  
**Minutes Release: January 6, 2010**  
**Next Meeting: January 26-27, 2010**

### Fed Funds Expectations

(Fed Funds futures, end of contract, %)



### Expected Expiration of Federal Reserve’s Special Liquidity Facilities

#### February 1, 2010

Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility  
 Commercial Paper Funding Facility  
 Primary Dealer Credit Facility  
 Term Securities Lending Facility  
 Central Banks temporary liquidity swap arrangements

#### June 30, 2010

Term Asset-Backed Securities Loan Facility  
 New-issue commercial mortgage-backed securities

#### March 31, 2010

Term Asset-Backed Securities Loan Facility  
 All other types of collateral

#### Early 2010

Term Auction Facility

	August 12	September 23	November 4	December 16	Comments
<b>Activity</b>	...economic activity is leveling out. Conditions in financial markets have improved further in recent weeks. Household spending has continued to show signs of stabilizing.	...economic activity has picked up following its severe downturn. Conditions in financial markets have improved further, and activity in the housing sector has increased.	...economic activity has continued to pick up. Conditions in financial markets were roughly unchanged... Activity in the housing sector has increased over recent months. Household spending appears to be expanding... Businesses are still cutting back on fixed investment and staffing, though at a slower pace.	...economic activity has continued to pick up and that the deterioration in the labor market is abating... The housing sector has shown some signs of improvement... Household spending appears to be expanding at a moderate rate... Financial market conditions have become more supportive of economic growth.	<b>Slow recovery</b>
<b>Inflation</b>	The prices of energy and other commodities have risen of late. However, substantial resource slack is likely to dampen cost pressures, and the Committee expects that inflation will remain subdued for some time.	With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.	With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.	With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.	<b>Lack of pressures</b>
<b>Risks</b>	economic activity is likely to remain weak for a time...	... economic activity is likely to remain weak for a time.	economic activity is likely to remain weak for a time.	economic activity is likely to remain weak for a time...	<b>Tilted towards growth</b>
<b>Quantitative Easing</b>	To promote a smooth transition in markets... the Committee has decided to gradually slow the pace of these transactions...	The Committee will gradually slow the pace of these purchases [MBS and agency debt] in order to promote a smooth transition in markets...	In order to promote a smooth transition in markets, the Committee will gradually slow the pace of its purchases of both agency debt and agency mortgage-backed securities.	In light of ongoing improvements in the functioning of financial markets... anticipate that most of the Federal Reserve's special liquidity facilities will expire on February 1, 2010.	<b>Official exit in 1Q10</b>
<b>Monetary Policy</b>	...economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period...	...economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.	...economic conditions... are likely to warrant exceptionally low levels of the federal funds rate for an extended period...	...economic conditions... are likely to warrant exceptionally low levels of the federal funds rate for an extended period...	<b>Low interest rates for several more quarters</b>
<b>Action</b>	0	0	0	0	<b>Unanimous</b>
<b>Fed Funds</b>	0.0-0.25%	0.0-0.25%	0.0-0.25%	0.0-0.25%	<b>Pause</b>

BBVA USA Economic Research Department interpretation of FOMC's perception regarding the economic variables included in the statement

December	
23	University of Michigan Consumer Sentiment Index
29	Conference Board Consumer Confidence Index
January	
9	Employment Situation
13	Ben Bernanke to deliver the Josiah Charles Stamp memorial lecture at the London School of Economics.
14	Retail Sales
16	Consumer Price Index
16	Industrial Production