U.S.

Fed Watch

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Economic Analysis

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FOMC Statement: September 21

FOMC becomes more worried

- **Downward risks to growth and inflation increased**
- **Fed hints that decision on further quantitative easing is likely in November 2-3**
- **These developments reaffirm our outlook of low interest rates for a prolonged period**

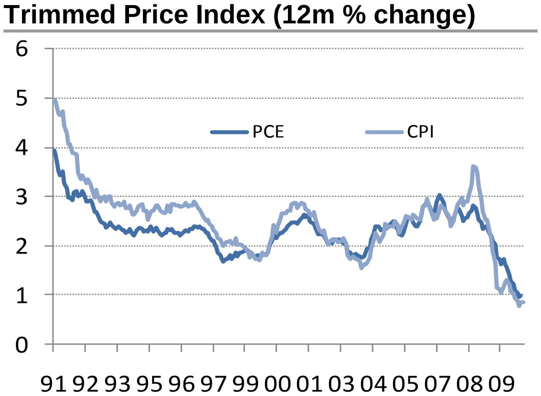
Today's statement included significant changes that recognize slower growth and higher deflationary risks. However, as we expected, the FOMC left monetary policy unchanged and there was no announcement of further quantitative expansion.

Officials recognized that: "Business spending on equipment and software is rising, **though less rapidly than earlier in the year**, while investment in nonresidential structures continues to be weak. Employers remain reluctant to add to payrolls. Housing starts are at a depressed level. Bank lending has continued to contract, **but at a reduced rate in recent months.**" Therefore, we expect members to revise down their forecasts which will be released on the next meeting in November 2-3.In addition, members became more concerned on deflationary risks and think that current inflation levels are "somewhat below those the Committee judges most consistent, over the longer run, with its mandate to promote maximum employment and price stability."

Therefore, the statement had two main objectives. First, it assures market participants that FOMC is considering policy options including a second round of quantitative easing (QE2), to avoid deflation. In fact, FOMC stressed that it "is prepared to provide additional accommodation if needed to support the economic recovery and to return inflation, over time, to levels consistent with its mandate." Second, it delays any potential decision on QE2 until next two-day meeting so that members can have more information on the pace of economic recovery and inflation trends.

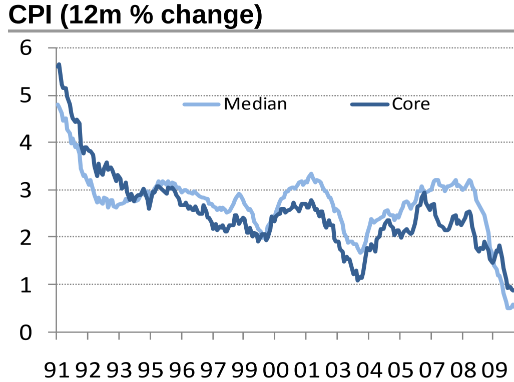
Summing up, the Fed left federal funds rate unchanged and in line with our scenario, it signaled that interest rates will remain low for a prolonged period. While the probability of QE2 has increased, future actions depend on incoming economic data until next FOMC meeting. In the meantime, speeches and the minutes will provide more details on the course of monetary policy in coming months.

Chart 1
Trimmed Price Index (12m % change)



Source: Cleveland Fed & Dallas Fed

Chart 2
CPI (12m % change)



Source: BLS & Cleveland Fed

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