

U.S.

Fed Watch

December 14, 2010

Economic Analysis

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FOMC Statement: December 14

Fed to continue as planned with large-scale asset purchases

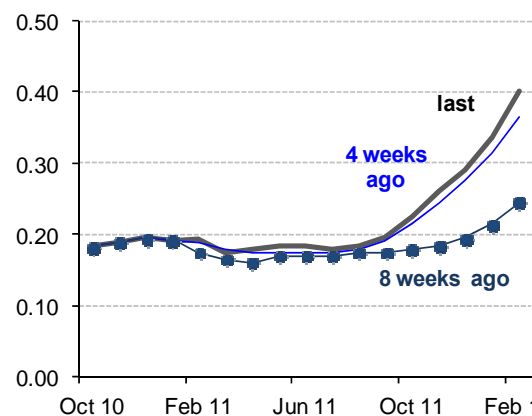
- Measures of underlying inflation continue to trend downward
- Reluctant hiring and insufficient economic recovery keeps unemployment high
- The housing sector remains depressed

Many indicators to monitor, but not pointing definitively in one direction

The Federal Open Market Committee (FOMC) released a statement today indicating no major changes to the current monetary policy stance, which is pursuing a combination of extremely low interest rates and large-scale asset purchases (LSAPs) to combat below-mandate inflation and employment. Of the few material changes to the statement, FOMC members upgraded their characterization of household spending increases from gradual to a moderate pace. Similar to November's statement, a number of conditions continue to drag on the overall economy: employers are reluctant to hire, tight credit conditions, modest income growth and a depressed housing sector. Disinflationary trends still persist, according to the FOMC.

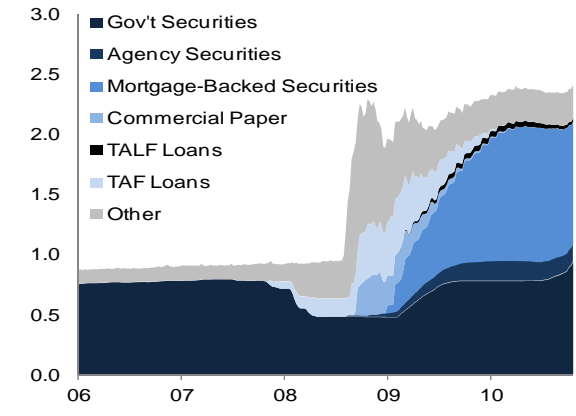
As a result of the above and in the context of slow progress towards achieving its dual mandate, the FOMC decided to continue its November decision to purchase \$600bn in Treasury securities by the end of 2011Q2. This program is in addition to its existing earlier decision to reinvest the principal from retiring mortgage-backed securities (MBS) held on the Federal Reserve's balance sheet. Naturally, the FOMC will also continue to hold the Fed Funds rate at 0 to .25 percent. As the LSAP program is still relatively new, very little macroeconomic data exists to evaluate the effects so far. Even if the data existed at a higher frequency, there should be a considerable lag effect. Financial markets, however, are reacting in different ways to both the LSAP program and new taxation policies by the government. These issues and their relationship with long-term rates, the term premium and inflation expectations are likely to occupy more of the FOMC's minutes in the future. Overall, today's statement by the Federal Reserve is consistent with our expectations for a low Fed Funds rate for an extended period of time.

Chart 1
Fed Funds Expectations (Futures Contract End, %)



Source: BBVA Research and Bloomberg

Chart 2
Factors Supplying Reserve Funds (\$tr)



Source: BBVA Research and Federal Reserve

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