BBVA Research

U.S.

Fed Watch

March 15, 2011

Economic Analysis

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FOMC Statement: March 15

Fed not yet concerned about oil, LSAP continues on track

- **FOMC believes labor market is on a firmer footing, but still not healthy**
- **Underlying measures of inflation are "subdued" rather than trending downward**
- **The Fed believes that recent increases in oil prices are transitory**

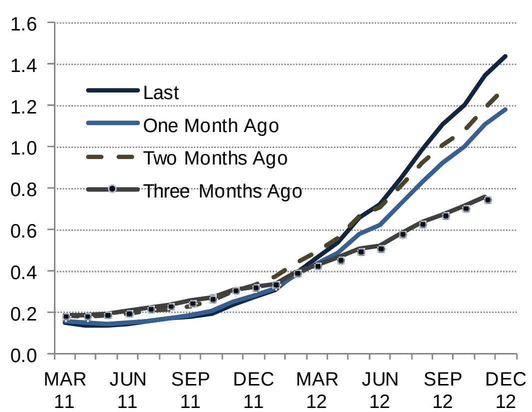
The Fed keeps the Fed Funds rate target unchanged

The Federal Open Market Committee (FOMC) released a statement today indicating no game-changing alterations 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. While the statement highlighted that labor market conditions are on a "firmer footing," the statement continued to be sanguine about unemployment, nonresidential structures investment and the housing sector. Consistent with our previous Economic Watch, the committee believes that recent oil price increases are transitory, therefore posing no long-term threat to price stability. While inflation expectations remain stable, the FOMC did not – in contrast to the last statement – state that "measures of underlying inflation" are trending downwards, but instead that they are "subdued." However, the latest data from the University of Michigan's survey of inflation expectations indicates a sharp rise in 1- and 5-year-ahead inflation expectations, most likely due to increases in gasoline prices.

To fulfill its dual mandate, the Fed decided to continue its implementation of LSAP as planned. As in previous statements, the Fed will continue to monitor economic and financial conditions and will adjust the program as necessary. As a result, the FOMC maintained the Fed Funds rate at 0 to .25 percent. Given international events such as the earthquake in Japan, oil shocks surrounding political events in the Middle East and North Africa, and subsequent financial market frictions, we now believe it is less likely that the next statement in April will contain substantial changes. 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

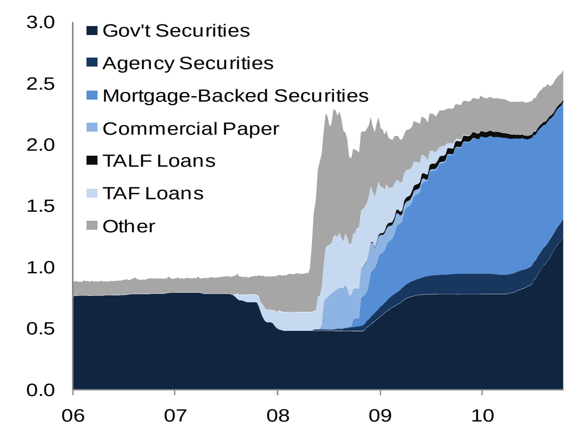
Fed Funds Expectations (Futures Contract End, %)



Source: BBVA Research and Bloomberg

Chart 2

Factors Supplying Reserve Funds ($tr)



Source: BBVA Research and Federal Reserve

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