BBVA RESEARCH

FED Watch

US

27 April 2011
Economic Analysis

US
Hakan Danış
hakan.danis@bbvacompass.com

Jeffrey Owen Herzog
jeff.herzog@bbvacompass.com

Nathaniel Karp
nathaniel.karp@bbvacompass.com

FOMC Statement: April 27

Bernanke Meets the Press

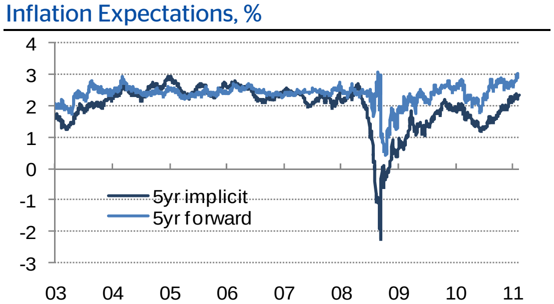
- **Press conference acts mainly as instrument of communications strategy**
- **FOMC revises down GDP and unemployment, increases inflation forecasts**
- **LSAP ends as planned, likely to not significantly affect financial markets**

Bernanke's press conference unveils FOMC forecasts earlier than usual

The Federal Reserve unveiled a statement characterizing the economy as displaying moderate growth overall, but still facing challenges in a depressed housing market. Labor market conditions are improving gradually, while consumer spending and business outlays on equipment and software remain robust. Indicators of excess resource slack are still elevated. FOMC members believe that recent rises in commodity prices will impart a transitory effect on the headline rate of inflation, with limited pass-through in the long run to measures of underlying inflation. In particular, FOMC members still view underlying measures of inflation as "subdued" and longer-term inflation expectations remain consistent with the Federal Reserve's dual mandate. The statement explicitly indicates that the Federal Reserve will complete its current large-scale asset purchase (LSAP) program at the end of 11Q2. Reinvestment of principal from maturing assets will continue until financial and economic conditions warrant a change in policy stance. The FOMC kept the Fed Funds target rate at between 0.0 and 0.25.

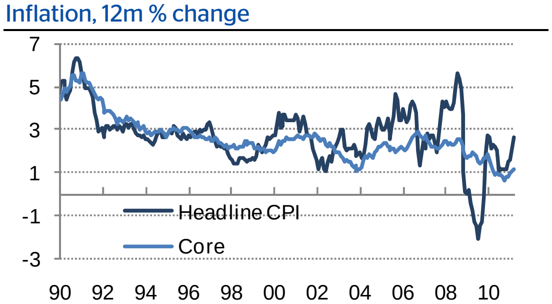
For the first time in the history of the Federal Reserve, the Chairman followed the meeting with a press conference. In our view, the press conference allows the Federal Reserve to more clearly articulate its economic forecast to the public, improve the transparency of the central bank's operations, and also provides a new method upon which to transmit its communications strategy. During the press conference, the Chairman detailed a slight downgrade of the FOMC's GDP forecast due to less defense spending, weaker construction and higher oil prices. The higher oil prices also triggered a slight increase in the FOMC's inflation forecast, but the Chairman emphasized that he will maintain a close watch on survey and market-based measures of inflation expectations. The Chairman also said the end of LSAP will not significantly affect interest rates. LSAP's success is evident in ameliorated spreads and volatility. He sees no need to taper purchases. With regard to the exit from extraordinarily low monetary policy, the Chairman said the cessation of reinvestment of principal would be one of the first steps. Notably, he mentioned that he would change the statement wording regarding "extended period" a couple of meetings before the first rate hike.

Chart 1
Inflation Expectations, %



Source: Haver Analytics & BBVA Research

Chart 2
Inflation, 12m % change

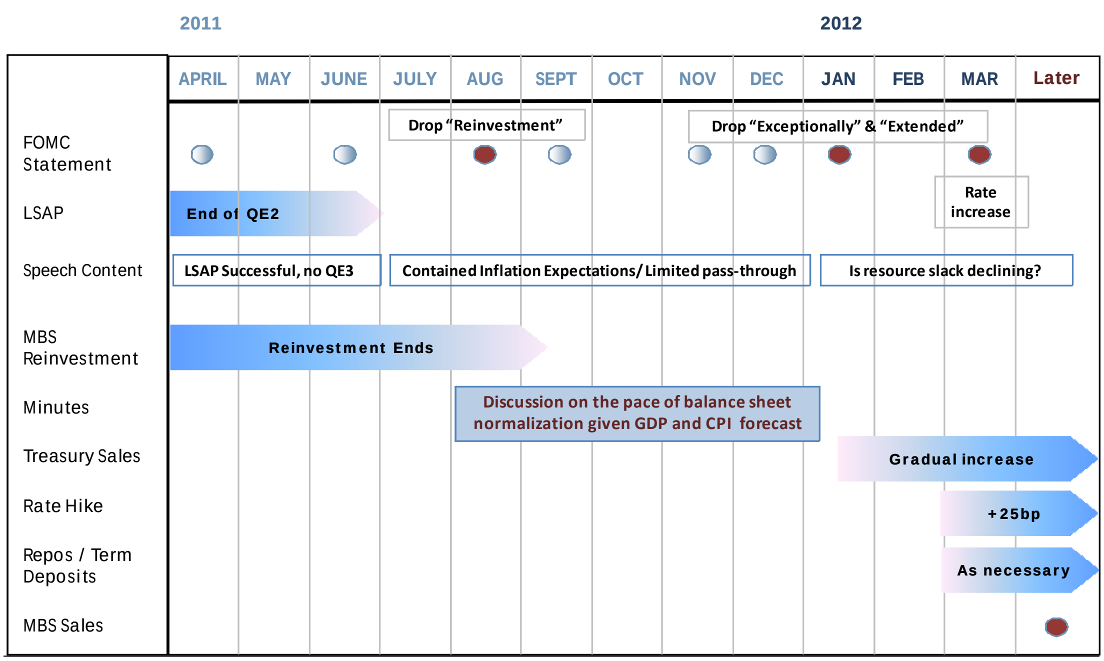


Source: Bloomberg & BBVA Research

Bottom line: uncertainty over sustainability of the recovery to weigh on policy action

Today's statement and press conference are consistent with our previous Fed Watch outlining the expected Federal Reserve exit strategy. In particular, it confirms our assessment that the Fed will complete LSAP as planned and with no tapering. Our supposition that reinvestment represents the first stage of the exit strategy is also confirmed by today's press conference. Our belief that the central bank would drop the "extended" phrasing for the statement around January (or in the previous meeting) is also confirmed by the Chairman's comments today. Overall, the Fed remains in no rush to raise interest rates as a result of excess resource slack, although it is increasingly focused on the evolution of measures of inflation expectations. Due to uncertainty over the sustainability of the recovery, the timing of policy actions (balance sheet normalization, in particular), will depend on the evolution of data over the summer. We continue to expect a first rate hike in March 2012.

Table 1
Expected Sequencing of Federal Reserve Monetary Policy



Source: BBVA Research

Table 2
Federal Reserve Forecast Comparison, April 27 FOMC Statement and Press Conference

January 2011 FOMC Projections

	2011	2012	2013	Long-term
GDP, yoy % change				
High	4.2	4.5	5.0	3.0
Low	3.2	3.4	3.0	2.4
Unemployment rate, %				
High	9.0	8.4	7.9	6.2
Low	8.4	7.2	6.0	5.0
Core PCE, yoy % change				
High	1.8	2.0	2.0	---
Low	0.7	0.6	0.6	---

April 2011 FOMC Projections

	2011	2012	2013	Long-term
GDP, yoy % change				
High	3.7	4.4	5.0	3.0
Low	2.9	2.9	3.0	2.4
Unemployment rate, %				
High	8.9	8.4	8.4	6.0
Low	8.1	7.1	6.0	5.0
Core PCE, yoy % change				
High	2.0	2.0	2.0	---
Low	1.1	1.1	1.2	---

Source: Federal Reserve