

Fed Watch

US

FOMC Statement Preview: March 13 Federal Reserve Still Unconvinced by Recent Data

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Economic Analysis

US
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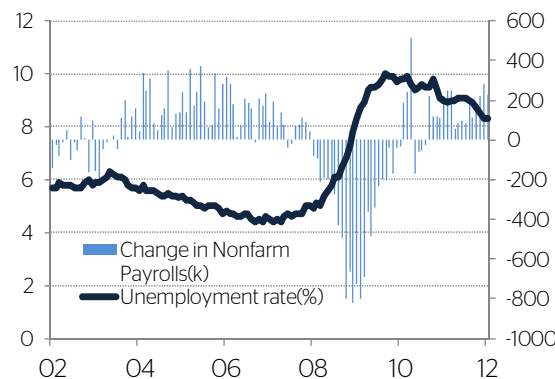
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- FOMC participants likely to focus on contrasting employment indicators
- Weak consumption expenditures and trade data to weigh on outlook
- Rumors of sterilized bond purchases circulate in the media

What to Expect from the Federal Reserve this Week

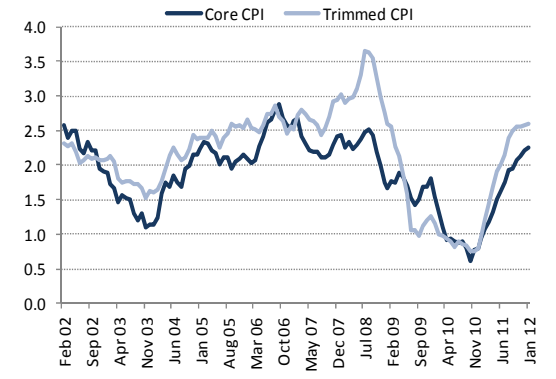
We expect tomorrow's Federal Reserve statement to highlight improvements in employment, general economic activity and firmer inflation as a result of higher energy prices. However, we also expect the statement to point to continued challenges to high growth as a result of household deleveraging, a damaged housing sector, and uncertain European sovereign debt negotiations. The statement will show that the Federal Reserve remains focused on high excess resource slack – in particular, excessively high unemployment duration and foreclosed home inventories – and is also unconvinced of the sustainability of the recovery. The recent strength in nonfarm payrolls can have mixed meanings when considering coincident weakness in productivity data. For example, if employers are adding workers only because they have exhausted productivity increases, then the strength of the nonfarm payroll data does not represent a sustainable recovery. Recent rumors in the press regarding a possible plan to utilize sterilized bond purchases (SBP) – asset purchases offset by term deposits or reverse repos – highlight the Federal Reserve's preparations for a potential post-Operation Twist scenario of insufficient growth and near-trend inflation. In general, if the economy arrives as we forecast in a mediocre pace of employment and growth by the time Operation Twist ends in late June, this sterilized system could in theory allow the Fed to maintain downward pressure on long term rates while at the same time avoiding an inflationary expansion of money supply. The effect on long-term interest rates would be the same as Operation Twist, but not the same as quantitative easing (QE) with money supply expansion. The state of the monetary regime is key: clearly QE with money supply expansion works well during a financial meltdown, but in slow growth and liquidity trap conditions where the relative holdings of assets are key to stimulating changes in long-term rates, and there is no clear risk of deflation, then this SBP could be an option. However, implementation is not an issue at present and this potential SBP will merely be discussed during tomorrow's meeting.

Chart 1
Unemployment Rate and Nonfarm Payroll



Source: Haver Analytics & BBVA Research

Chart 2
Trend Measures of Inflation



Source: Haver Analytics & BBVA Research

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