The week in the US

Airplane!

The Fed is in the process of trying to "land the ship in a smooth way onto the aircraft carrier", which will soon involve reducing thrust

No change in the Fed's policy was expected and the FOMC delivered just that: the third wave of quantitative easing will keep on being implemented at the exact same pace of USD 40 bn of monthly MBS purchases and USD 45 bn of long-dated Treasuries. The Fed Fund Target remains in the 0-0.25% range, and will be kept there as long as the unemployment rate does not break the 6.5%-threshold, unless prospects are for inflation to accelerate above 2.5% within a 1 to 2 year horizon. As it has been the case since the beginning of the year, the decision was not consensual, as Esther George dissented, as she is concerned that "*the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in long-term inflation expectations*". But this time, another member dissented: James Bullard, President of the St Louis Fed, who believed "*that the Committee should signal more strongly its willingness to defend its inflation goal in light of recent low inflation readings*".

Today were published the updated forecasts from FOMC members (voting and non-voting) for GDP growth, the unemployment rate, the pace of increase in the PCE deflator (headline and core) as well as the likely timing of policy firming and the likely level of the Fed Fund Target over the next two years. From March 2013, revisions were marginal, however pointing to growing optimistic. On balance, Fed members seem slightly less optimistic about GDP growth this year, but more optimistic for the next couple of years. They are also slightly more optimistic about the pace of decrease in the unemployment rate.

The more optimistic tone is also obvious in the statement, as it notes that "*The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished since the fall*", also signalling that "*labor market conditions have shown further improvement in recent months*".

As for the updated forecasts, the main point is the downward revisions to PCE inflation (deflator of private consumption) that not a single member project to be higher than 2.5% in the foreseeable future, while most members sees it remaining below the Fed's target of 2% both this year and next. Chairman Bernanke stressed during his press brief that, for the time being, FOMC members were not concerned about that the slowing down of inflation, even if were such a development keep going it would not be welcomed, raising real interest rates, increasing the probability of deflation of delaying the deleveraging process.

Another key point is the fact that one member changed his (or her) view about the appropriate timing of policy firming: in March, there were 4 members seeing 2014 as the appropriate date, and they now are only 3.

When is it appropriate to raise rates?

December 2012 ; March 2013 ; June 2013

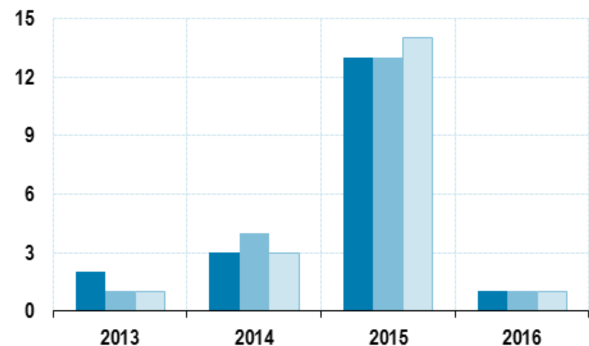

Chart — Source : Federal Reserve

During the press brief, Chairman Bernanke declared that FOMC members were actively discussing the exit strategy, and he announced that, as for now, the view was that the 2011 plan was still a good plan, except for one part: members now expect not to sell MBS during the process, simply letting then maturing.

The breaking news was delivered during the press brief when Chairman Bernanke declared that the Fed was very likely to slow down the pace of monthly security purchases "*later this year*", progressively cutting the amount to finally end QE3 by "*the middle of next year*". By then, the unemployment rate would be in the vicinity of 7%. He also stressed that this taper off would be data-dependent, including monetary and financial conditions: the slowdown could be delayed, were data be disappointing, but also reversed as the Fed would be ready to increase monthly security purchases. Were labour market conditions improve faster, QE3 would be ended sooner.