



Fed Watch

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FOMC Minutes from September 22-23, 2009

- Staff revised GDP forecast upward; labor market weak
- Inflation likely to remain subdued; exit strategies discussed
- Target rate will remain at 0%-0.25% for an extended period

Recent consumer spending and housing market data show initial signs of recovery. Despite the staff's upward revision of GDP growth, unemployment remains high and employment growth will remain low. "Participants emphasized that the labor market remains weak," and they expect only "moderate growth in consumer spending." Some individuals viewed the housing market developments with caution partly due to temporary tax provisions and sustained foreclosures. Attendees remain concerned about deterioration in the commercial real estate market, as "activity continued to fall markedly in most districts." As positive notes, inventory reduction and fixed investment are declining at slower rates, and thus firms are raising production to meet demand. Additionally, "participants marked up their outlook for foreign economies" which "would support growth in U.S. exports."

Inflation expectations remain unchanged, and "the staff forecast core inflation to slow somewhat further over the next two years." In line with the forecast, many participants regarded inflationary risks as being "roughly balanced" because "slack in both labor and product markets would be substantial over the next few years, leading to subdued and potentially declining wage and price inflation." While there was some disagreement about the real-time measurement of slack and its effects on inflation, "all participants recognized that inflation expectations... needed to be carefully monitored."

"[T]he Committee anticipated that inflation would remain subdued for some time" and "judged that costs of growth turning out to be weaker than anticipated could be relatively high." Thus, conditions justify an "exceptionally low level of the federal funds rate for an extended period."

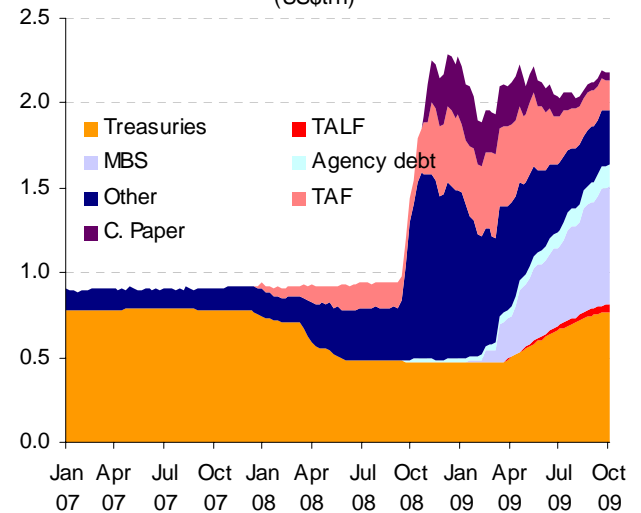
Discussion turned to the effects of the Fed's balance sheet on inflation expectations. Participants all agreed that the Fed must continue "to communicate that it has the tools and willingness to begin withdrawing monetary policy accommodation at the appropriate time and pace to prevent any persistent increase in inflation." Some members argued for increasing the maximum purchase limit of MBS, while one member argued for a reduction. Currently, however, all agreed that the Fed should maintain and reinforce its intentions to purchase the full \$1.25 trillion of agency MBS and \$200 billion of agency debt previously established. They agreed to extend these programs into 1Q10, but to "slow the pace of [these] purchases." Depending on realized economic and financial conditions, "members discussed the importance of maintaining flexibility to expand or scale back the asset purchase programs."

Bottom-line:

The minutes reinforce our baseline forecast of moderate economic growth in the near term, low inflation and a slow recovery in the labor market. Thus, we maintain our forecast of a low target federal funds rate for a considerable time forward. The preliminary discussions of exit strategies are at an early stage and do not indicate a rate hike soon. The discussions reflect the Committee's desire to enhance communication and keep inflation expectations stable.

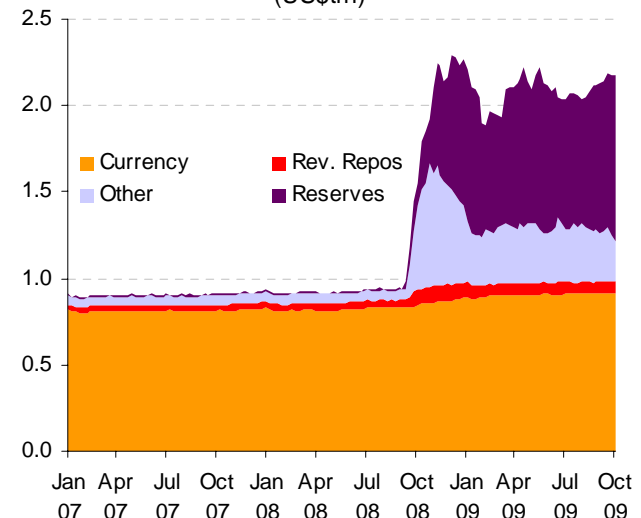
Fed Funds: 0% to 0.25%
Next Meeting: November 3-4
Minutes Release: November 25

Total factors supplying reserve funds (US\$trn)



Source: Fed

Total factors absorbing reserve funds (US\$trn)



Source: Fed