

# Flash Comment

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## FOMC: Ready to scale up purchases

**Overview:** The Federal Open Market Committee (FOMC) decided at its policy meeting to keep the fed funds rate unchanged in the 0-0.25% range. Moreover, the committee signalled that the fund rate will remain low for a long time. It was decided not to scale up mortgage bond purchase programs or start buying Treasury securities. Richmond Fed President Lacker dissented, preferring to expand the monetary base by purchasing Treasuries rather than through targeted credit programs.

The market was slightly disappointed that the message was not more dovish. Following the announcement the curve twisted with 10-year Treasury yields moving 5-8bps higher and the 2-year segment moving lower by a few bps. Equity markets lost some ground but remained up. The currency market saw the biggest move with the USD strengthening and EUR/USD moving over one big figure lower approaching the 131 level.

**Details:** The Fed accepted that the economy had weakened further but noted an improvement in several financial markets amid still very tight credit conditions. The growth forecast from the previous meeting was unchanged. The committee continues to expect a gradual recovery later this year. Consequently, incoming data have only served to confirm members' already downbeat outlook.

On inflation the statement moved one step further on emphasizing the deflation risk by noting that there was a "risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term". However, this still suggests that the committee sees a relatively limited risk of a deflationary spiral developing.

The committee "employ all available tools to promote the resumption of sustainable economic growth" and remains biased against expanding its balance sheet further. This could happen either through an expansion of the size or duration of the MBS and agency debt purchase program or by purchasing treasuries. Nothing of this is new compared to the previous meeting.

**Assessment & Outlook:** The meeting warrants no change to our policy outlook. We expect the Federal Reserve to retain zero rates for a long time. On the short-to-medium term horizon the risk remains of further quantitative easing by expanding the balance sheet. Rate hikes will not be on the agenda before the economy returns to trend and unemployment has peaked.

Statement on page 2.

**Current statement:**

The Federal Open Market Committee decided today to keep its target range for the federal funds rate at 0 to 1/4 percent. The Committee continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.

Information received since the Committee met in December suggests that the economy has weakened further. Industrial production, housing starts, and employment have continued to decline steeply, as consumers and businesses have cut back spending. Furthermore, global demand appears to be slowing significantly. Conditions in some financial markets have improved, in part reflecting government efforts to provide liquidity and strengthen financial institutions; nevertheless, credit conditions for households and firms remain extremely tight. The Committee anticipates that a gradual recovery in economic activity will begin later this year, but the downside risks to that outlook are significant.

In light of the declines in the prices of energy and other commodities in recent months and the prospects for considerable economic slack, the Committee expects that inflation pressures will remain subdued in coming quarters. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.

The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability. The focus of the Committee's policy is to support the functioning of financial markets and stimulate the economy through open market operations and other measures that are likely to keep the size of the Federal Reserve's balance sheet at a high level. The Federal Reserve continues to purchase large quantities of agency debt and mortgage-backed securities to provide support to the mortgage and housing markets, and it stands ready to expand the quantity of such purchases and the duration of the purchase program as conditions warrant. The Committee also is prepared to purchase longer-term Treasury securities if evolving circumstances indicate that such transactions would be particularly effective in improving conditions in private credit markets. The Federal Reserve will be implementing the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses. The Committee will continue to monitor carefully the size and composition of the Federal Reserve's balance sheet in light of evolving financial market developments and to assess whether expansions of or modifications to lending facilities would serve to further support credit markets and economic activity and help to preserve price stability.

**Previous statement:**

The Federal Open Market Committee decided today to establish a target range for the federal funds rate of 0 to 1/4 per-cent.

Since the Committee's last meeting, labor market conditions have deteriorated, and the available data indicate that consumer spending, business investment, and industrial production have declined. Financial markets remain quite strained and credit conditions tight. Overall, the outlook for economic activity has weakened further.

Meanwhile, inflationary pressures have diminished appreciably. In light of the declines in the prices of energy and other commodities and the weaker prospects for economic activity, the Committee expects inflation to moderate further in coming quarters.

The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to pre-serve price stability. In particular, the Committee anticipates that weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.

The focus of the Committee's policy going forward will be to support the functioning of financial markets and stimulate the economy through open market operations and other measures that sustain the size of the Federal Reserve's balance sheet at a high level. As previously announced, over the next few quarters the Federal Reserve will purchase large quantities of agency debt and mortgage-backed securities to provide support to the mortgage and housing markets, and it stands ready to expand its purchases of agency debt and mortgage-backed securities as conditions warrant. The Committee is also evaluating the potential benefits of purchasing longer-term Treasury securities. Early next year, the Federal Reserve will also implement the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses. The Federal Reserve will continue to consider ways of using its balance sheet to further support credit markets and economic activity.

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