



Fed Watch

April 29, 2009

The FOMC acknowledged signs of stabilization

- Target rates of 0%-0.25% are maintained
- Signs of stabilization in the economy but activity will remain weak for some time
- Downside risks to inflation continue

The FOMC decided to maintain its target interest rate at 0% to 0.25%. In the intermeeting period, the economy continued to contract “*though the pace of contraction appears to be somewhat slower.*” Household spending, in particular, has shown signs of stabilization, which is demonstrated by today’s positive PCE results. The overall message is a significant change from the previous statement, which stressed that the main economic indicators contracted further. The FOMC acknowledged that although the economic outlook improved somewhat since March, due in part to some easing of financial market conditions, economic activity is likely to remain weak for some time. This suggests that long-term prospects point to a prolonged period of weakness.

In light of these developments, the FOMC continues to be confident that fiscal and monetary stimulus will contribute to the renewal of “*sustainable economic growth in a context of price stability.*” The committee maintained its position that inflation will remain low due to ongoing economic slack, while downside risks persist.

Furthermore, the ongoing economic environment warrants very low interest rates for a relatively long period of time. In addition, rather than announcing further measures to boost liquidity in financial markets, the Fed maintained the planned allocations for purchases of agency MBS, agency debt and Treasury securities announced in the previous meeting with the intention to evaluate the levels as the economic and financial outlook evolves.

Bottom-line: Today’s FOMC statement sends a more positive message than the previous one due to signs of stabilization in personal consumption and financial conditions. Therefore, it appears that there was less of a need to debate the alternatives to expand the Fed’s balance sheet. Looking forward, if signs of stabilization persist, we do not expect the Fed to increase its allocations for purchasing securities. Although the market has adjusted down its expectations for the fed funds rate, we still believe that ample economic slack and a slow recovery will drive the Fed to keep interest rates low for a prolonged period of time.

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Fed Funds: 0.0-0.25%
Minutes Release: May 20, 2009
Next Meeting: June 23-24, 2009

Corporate Spreads
 (Moody's Baa, bp)



Fed Funds Expectations
 (Fed Funds futures, end of contract, %)

