

FOMC holds rate policy steady at 0 to 0.25%, prepared to buy treasuries if warranted, USD firms

The Fed elected to keep its target range unchanged at 0 to 0.25%. The Fed anticipates that economic conditions will warrant exceptionally low Fed funds rates for some time. The Fed says that the economy has weakened further since they met in December noting declining industrial production, housing starts, employment and businesses cutting back spending. The Fed said global demand has slowed significantly. The Fed expects gradual economic recovery later this year but notes significant downside risks to the economy. In light of the decline in energy prices and commodities the Fed sees inflation pressures subdued. The Fed will continue to purchase large amounts of agency debt and mortgage-backed securities. The Fed said that it is prepared to buy long-term treasuries if circumstances indicate that such purchases would be effective in improving conditions in credit markets. The fact that the Fed did not announce an immediate plan to buy treasuries may be seen as a disappointment. The trade will monitor how equities react to the Fed's statement. USD firmed after the Fed policy announcement as the Fed failed to offer any new or unconventional measures to boost the economy and credit markets. The fact that the Fed will not immediately buy treasuries may inject fresh risk aversion supporting USD. The Fed may ultimately buy treasuries and this could improve confidence in the US bond market and encourage investment flows to the USD. Fed policy action is only part of the equation as focus shifts to the expected passage of a new US fiscal stimulus plan.

The Fed lowered rates about as far as it can to try and stimulate the economy and combat the global credit crisis. The trade was looking for the Fed to announce unconventional measures to boost growth and credit markets. There's a great deal of speculation that Fed and US Treasury may soon buy toxic assets of US banks. There also is significant focus on U.S. Congress and the prospect of passage of a new stimulus plan to try and boost the US economy. The stimulus plan could top 825 billion dollars. The Obama stimulus plan will rely on deficit spending to boost growth. It is not clear whether taking toxic loans off the books of US banks or the government trying to spend its way to prosperity will work, but there appears to be a growing sense of hope that these actions will improve the outlook for the US economy. Equity markets rallied today reflecting hope the US government plans to deal with the US economic crisis will work.

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