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Federal Open Market Committee Press Release, August 12, 2009



Eugene Lancaric, CFA
Multi-Asset
Strategies and
Solutions Group

At the conclusion of a two-day meeting this afternoon, the Federal Open Market Committee (FOMC) announced that it intends to maintain its current policy stance largely unchanged. Its evaluation of economic conditions, however, was less pessimistic than that released after the June 24 meeting, and the committee provided more detail about the timing of its purchases of U.S. Treasury securities.

- The most important contrast between today's statement and June's is that the FOMC now believes that economic activity is "leveling out" rather than still contracting. Comments on most aspects of the economic outlook are slightly more positive: financial conditions have "improved further"; household spending has "continued to show signs of stabilizing," and businesses "are making progress" in aligning inventories with demand rather than simply "appear" to be making progress. However, the FOMC also added a new negative -- "sluggish income growth" -- to the factors it saw as depressing consumer spending; this is appropriate since, as we've noted in past comments, real after-tax income in recent quarters has been bolstered by tax cuts, government transfers and falling prices. None of these is likely to provide much further support to incomes any time soon.
- The FOMC still expects economic activity to remain weak "for a time" but expressed continued confidence that a combination of policy measures and autonomous market forces would lead to a revival of growth. All in all, as with similar meeting statements since economic conditions began improving earlier this year, the FOMC's assessment appears to err on the side of caution.
- Wording on inflation in the statement was unchanged from June. The FOMC notes that energy and other commodity prices "have risen of late" but remains convinced that "substantial resource slack" (i.e., high unemployment) is likely to keep cost pressures well-controlled. Inflation thus is still likely to "remain subdued for some time" in the committee's view. As we have pointed out in past comments, this view reflects the "output gap" model used by the Federal Reserve and many monetary economists to forecast inflation. With unemployment as much as 4.5% above its so-called "natural rate," (roughly put, the rate that would prevail in equilibrium when economic activity was at or close to its potential level) and likely to remain elevated for a few years even after growth revives, output gap models predict that there will be little if any inflationary pressure arising from wage demands and hence from unit labor costs. Nevertheless, it may be that some of the unemployment we currently observe, such as the collapse in auto industry jobs, reflects structural rather than cyclical factors. To the extent this is true, the natural rate of unemployment may be higher, and hence the output gap smaller, than the FOMC or Fed research staff believe.
- The committee has left the stance of monetary policy virtually unchanged from June: it remains committed to use "all available tools" to promote economic recovery; it will maintain the Fed Funds rate target in its current zero to 25 basis-point range, and it continues to see Fed Funds as remaining "exceptionally low" for an extended period. The asset purchase programs have not changed, but the FOMC commented that it would begin to slow the pace of Treasury bond purchases with a view to completing the \$300 billion target amount by the end of October. The previous statement had only said that these securities would be bought "by autumn."

Source: U.S. Federal Reserve

The outcome of this week's meeting is largely in line with market expectations. It remains highly unlikely that the FOMC will begin raising the Fed Funds rate target until the second quarter of next year. ■

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