Gleanings from FOMC Press Conference

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QE3 is sunk

Asked about the possibility of QE3, Fed Chairman Bernanke said "Why not do more? The trade-offs are getting less attractive at this point. Inflation has gotten higher. Inflation expectations are a bit higher. It's not clear that we can get substantial improvements in payrolls without some additional inflation risk. And in my view, if we're going to have success in creating a long-run, sustainable recovery with lots of job growth, we've got to keep inflation under control. So we've got to look at both of those—both parts of the mandate as we—as we choose policy."

Likely Q1 GDP slowdown "transitory"…guidance on "extended period"

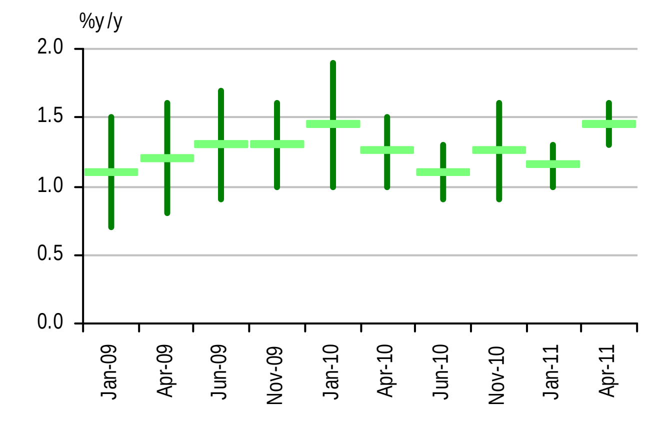
Chairman Bernanke described the expected slowdown in Q1 as largely due to factors thought to be "transitory". In other news, he argued that an "extended period" was a "couple of meetings", a phrase that could suggest a shorter time frame than is generally expected.

Lower forecasts for growth and unemployment, higher inflation expected

Updated central tendency projections show that the FOMC growth forecast was lowered to 3.2% (q4/q4) in April from 3.65% in January. Despite the lowering of the GDP estimate for 2011, the FOMC also lowered its unemployment rate outlook for 2011 (to 8.55% from 8.90%) and increased its core PCE inflation forecast for 2011 to 1.45% from 1.15%. Somewhat oddly, the FOMC also lowered its estimate of "longer run" unemployment, a proxy for the non-accelerating inflationary rate of unemployment (NAIRU), to 5.4% from 5.5%.

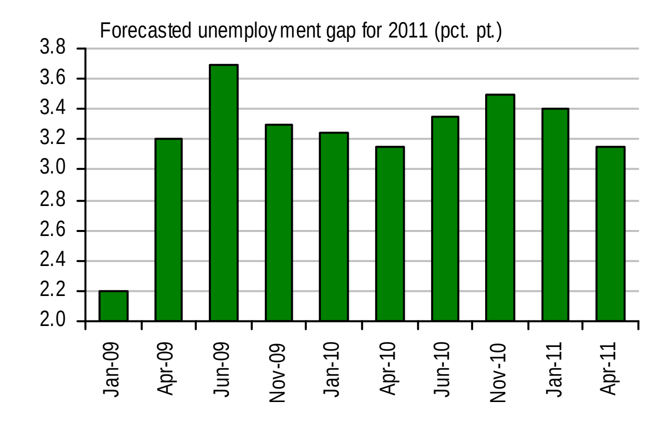
The path of the employment forecasts suggests that the FOMC sees the recent drop in the unemployment rate as something that temporarily lowers the unemployment rate but does not alter the trend. The unemployment rate forecast for Q4 2011 was revised down by 35bp, 2012 by 10bp and 2013 was left unchanged at 7.0%.

Core PCE inflation forecast midpoint for 2011 at 1.45%, up from 1.15% in January.



Note: Vertical line represents range of forecasts; horizontal line represents the midpoint of the forecasts. Source: Federal Reserve and UBS.

The Fed lowered their 2011 unemployment rate forecast to 8.55% but also lowered their estimate of the natural rate, to 5.4% from 5.5%.



Note: "Gap" represents difference between 2011 unemployment forecast and the "longer run" forecast." Source: Federal Reserve and UBS.

Asked what happens when QE2 ends, Mr. Bernanke said "Our view is that … the end of the program is unlikely to have significant effects on financial markets or the economy". That's because the Fed has communicated the end date clearly, and financial markets have anticipated the end. He also said that he sees the stock of Fed holdings as driving the financial market effects rather than the flow of Fed holdings. So the amount of accommodation remains constant after QE2 ends. Stopping or slowing mortgage reinvestments would be a policy tightening. Mr. Bernanke gave no sense of timing.

FOMC statement. There has been some question about how to interpret the new language on growth that appeared in the FOMC statement. We read the new language as a bit of an upgrade: the recovery is "proceeding at a moderate pace"—implying some momentum, rather than merely being "on a firmer footing". That debate may continue, but Mr. Bernanke didn't suggest any significant new worries about growth. The soft spot in Q1 was seen as transitory, and he sounded increasingly confident of labor market momentum.

FOMC Statements—April 27 versus March 15

New language is marked in red; erasures from the March 15 statement are struck through.

Information received since the Federal Open Market Committee met in ~~January suggests~~March indicates that the economic recovery is ~~on~~ proceeding at a ~~firmer footing,~~ moderate pace and overall conditions in the labor market ~~appear to be~~ are improving gradually. Household spending and business investment in equipment and software continue to expand. However, investment in nonresidential structures is still weak, and the housing sector continues to be depressed. Commodity prices have risen significantly since ~~the~~ last summer, and concerns about global supplies of crude oil have contributed to a ~~sharp run-up in~~ further increase in oil prices since the Committee met in March. Inflation has picked up in recent ~~weeks. Nonetheless,~~ months, but longer-term inflation expectations have remained stable~~,~~ and measures of underlying inflation ~~have been~~are still subdued.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. ~~Currently, the~~ The unemployment rate remains elevated, and measures of underlying inflation continue to be somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate. ~~The recent increases~~ Increases in the prices of energy and other commodities ~~are currently putting upward pressure on~~have pushed up inflation~~.~~ in recent months. The Committee expects these effects to be transitory, but it will pay close attention to the evolution of inflation and inflation expectations. The Committee continues to anticipate a gradual return to higher levels of resource utilization in a context of price stability.

To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to continue expanding its holdings of securities as announced in November. In particular, the Committee is maintaining its existing policy of reinvesting principal payments from its securities holdings and ~~intends to purchase~~ will complete purchases of $600 billion of longer-term Treasury securities by the end of the ~~second~~current quarter~~ of 2011.~~. The Committee will regularly review the ~~pace~~size and composition of its securities ~~purchases and the overall size of the asset-purchase program~~holdings in light of incoming information and ~~will~~ is prepared to adjust ~~the program~~those holdings as needed to best foster maximum employment and price stability.

The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; William C. Dudley, Vice Chairman; Elizabeth A. Duke; Charles L. Evans; Richard W. Fisher; Narayana Kocherlakota; Charles I. Plosser; Sarah Bloom Raskin; Daniel K. Tarullo; and Janet L. Yellen.

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