Essentials of the Monetary Policy

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FEDERAL RESERVE

Securities purchases continue to wind down

ACCORDING TO THE FEDERAL RESERVE (Fed)

- The Committee decided to keep the target range for the federal funds rate at 0.00% to 0.25%.
- The Fed has once again tapered its monthly securities purchases by US$10B. As of February, the Fed will purchase US$30B in mortgage-backed securities (instead of US$35B), and US$35B in Treasury securities (instead of US$40B).
- The current target range for federal funds should remain appropriate well after the jobless rate falls below 6.5%, especially if inflation remains below the 2.0% target.
- Growth in economic activity picked up in recent quarters. Labor market indicators were mixed but on balance showed further improvement. The unemployment rate declined but remains elevated. Household spending and business fixed investment advanced more quickly in recent months, while the recovery in the housing sector slowed somewhat. Fiscal policy is restraining economic growth, although the extent of restraint is diminishing.
- Inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable. The Committee is monitoring inflation developments carefully for evidence that inflation will move back toward its objective.
- The Committee sees the risks to the outlook for the economy and the labor market as having become more nearly balanced. If incoming information broadly supports the Committee's expectation, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings.

COMMENTS

It comes as no surprise that the Fed leaders opted to shave its monthly bond purchases by US$10B. When the Fed announced in early December that it would begin tapering its purchases, Ben Bernanke had suggested that if the economic conditions so permitted, securities purchases would continue to wind down at the same pace. Also of note is that this is the last meeting to be led by Ben Bernanke. Janet Yellen will take the lead at the Fed on February 1; she is set to chair the first meeting of the monetary policy committee scheduled for March 18 and 19.

Certain factors could have given pause to some members of the monetary policy committee (the make-up of which has changed slightly in the new year). The 74,000 new hires reported in December was very disappointing. Other indicators also pointed to some weaknesses at the end of 2013. This is especially the case with the ISM non-manufacturing index, new durable goods orders, automobiles sales and home sales. The stock market's struggles since the beginning of the year and worries about the situation in emerging economies are also causing concerns. In addition, inflation remains fairly weak, which should not worry the more hawkish committee members. All of the above clearly did not weigh enough in the balance since the Fed has decided to stay the course. The good showing by the other indicators is also of note. Consensus even expects the last quarter of 2013 to post real GDP growth in excess of 3%, despite October's budget impasse, which dealt a blow to confidence. The easing of political constraints that undermined the U.S. economy last year has made room for more optimism. Much clearer signs of slippage would have to be seen for the Fed to slow down the pace of its tapering, a pace that appears to be set in advance. Based on our economic and financial scenarios, the stimulus purchases will end for good after the Fed's meeting in October.

At 6.7% in December, the jobless rate is edging closer to the 6.5% threshold previously set by the Fed. While no announcement was made today, we have to expect the Fed to make changes in March to the forward guidance on key rates.

Implications: Today's announcement should not have much impact on financial markets. Securities purchases will continue to wind down at the same pace announced in December and reiterated in January, i.e. US$10B per meeting. We do not expect any increase in key rates before September 2015.

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Note to readers: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

Schedule 2014 of Central Bank meetings

		Decision	Rate
JANUARY			
9	European Central Bank	s.q.	0.25
9	Bank of England	s.q.	0.50
15	Bank of Brazil	+50 b.p.	10.50
22	Bank of Canada	s.q.	1.00
22	Bank of Japan	---	---
29	Federal Reserve	s.q.	0.25
30	Reserve Bank of New Zealand		
31	Bank of Mexico		
FEBRUARY			
4	Reserve Bank of Australia		
6	European Central Bank		
6	Bank of England		
12	Bank of Sweden		
18	Bank of Japan		
26	Bank of Brazil		
MARCH			
4	Reserve Bank of Australia		
5	Bank of Canada		
6	European Central Bank		
6	Bank of England		
11	Bank of Japan		
13	Reserve Bank of New Zealand		
19	Federal Reserve		
20	Swiss National Bank		
21	Bank of Mexico		
27	Bank of Norway		
APRIL			
1	Reserve Bank of Australia		
2	Bank of Brazil		
3	European Central Bank		
8	Bank of Sweden		
8	Bank of Japan		
10	Bank of England		
16	Bank of Canada		
24	Reserve Bank of New Zealand		
25	Bank of Mexico		
30	Bank of Japan		
30	Federal Reserve		
MAY			
6	Reserve Bank of Australia		
8	European Central Bank		
8	Bank of England		
8	Bank of Norway		
21	Bank of Japan		
28	Bank of Brazil		
JUNE			
3	Reserve Bank of Australia		
4	Bank of Canada		
5	European Central Bank		
5	Bank of England		
6	Bank of Mexico		
12	Reserve Bank of New Zealand		
13	Bank of Japan		
18	Federal Reserve		
19	Bank of Norway		
19	Swiss National Bank		

		Decision	Rate
JULY			
1	Reserve Bank of Australia		
2	Bank of Sweden		
3	European Central Bank		
10	Bank of England		
11	Bank of Mexico		
15	Bank of Japan		
16	Bank of Brazil		
16	Bank of Canada		
24	Reserve Bank of New Zealand		
30	Federal Reserve		
AUGUST			
5	Reserve Bank of Australia		
7	European Central Bank		
7	Bank of England		
8	Bank of Japan		
SEPTEMBER			
2	Reserve Bank of Australia		
3	Bank of Sweden		
3	Bank of Brazil		
3	Bank of Canada		
4	European Central Bank		
4	Bank of England		
4	Bank of Japan		
5	Bank of Mexico		
11	Reserve Bank of New Zealand		
17	Federal Reserve		
18	Bank of Norway		
18	Swiss National Bank		
OCTOBER			
2	European Central Bank		
7	Reserve Bank of Australia		
7	Bank of Japan		
9	Bank of England		
22	Bank of Canada		
23	Bank of Norway		
27	Bank of Sweden		
29	Bank of Brazil		
29	Federal Reserve		
30	Reserve Bank of New Zealand		
31	Bank of Japan		
31	Bank of Mexico		
NOVEMBER			
4	Reserve Bank of Australia		
6	European Central Bank		
6	Bank of England		
19	Bank of Japan		
DECEMBER			
2	Reserve Bank of Australia		
3	Bank of Brazil		
3	Bank of Canada		
4	European Central Bank		
4	Bank of England		
5	Bank of Mexico		
11	Bank of Norway		
11	Reserve Bank of New Zealand		
11	Swiss National Bank		
15	Bank of Sweden		
17	Federal Reserve		
19	Bank of Japan		

NOTE: Certain banks may decide to change rates in-between the scheduled meetings. The abbreviations s.q. and b.p. correspond to status quo and basis points respectively.