

Flash Comment

FOMC minutes: QEII threshold still unclear

- FOMC members and staff revised down their growth forecasts for H2 while leaving potential for disappointments compared to our expectations.
- Triggers for further quantitative easing remain unclear. Guided by Bernanke's Jackson Hole speech, consumer spending and the labour market are key.
- Even if data continue to disappoint, we believe disagreement within the committee will defer any major policy action until after the September meeting.

Details

Minutes of the August 10 FOMC meeting showed members reducing their expectations for H2 10 growth compared to their June forecasts. By exactly how much they did so is unclear although those members submitting the lowest projections for GDP growth (2.9% Q4/Q4) stated that recent data were in line with their expectations.

This remains slightly higher than our 2010 growth forecast (2.1% Q4/Q4) even after adjusting for revisions to Q2 GDP growth received after the August 10 meeting. There is therefore scope for negative surprises concerning FOMC expectations in coming months.

Significantly, "some members expressed a concern that in this context any further adverse shocks could have disproportionate effects, resulting in a significant slowing in growth going forward".

Nevertheless, QEII is by no means a done deal. On the decision to reinvest mortgage proceeds, a few members thought that "the economic effects of reinvesting principal from agency debt and MBS likely would be quite small". Further the minutes stated that "a few members worried that reinvesting principal from agency debt and MBS in Treasury securities could send an inappropriate signal to investors about the Committee's readiness to resume large-scale asset purchases".

The minutes also restated that "in addition to continuing to develop and test instruments to facilitate an eventual exit ..., the Committee would need to consider steps it could take to provide additional policy stimulus if the outlook were to weaken appreciably further". So far most members agreed that "reinvesting in Treasury securities was seen as preferable given current market conditions, reinvesting in MBS might become desirable if conditions were to change". This is consistent with Bernanke's speech last week.

Assessment and outlook

The minutes confirm what we knew from last week's Fed speeches. The decision to reinvest mortgage proceeds was made to maintain the status quo and not to provide additional stimulus. The FOMC's minutes leave us little wiser on the threshold for potential additional QE. While it remains uncertain whether growth below 2% in H2 2010 (our current expectation) will be sufficient to trigger a new round of easing, given current disagreements within the committee we believe the September 21 meeting will be too soon to expect any policy action.

FOMC economic projections

FOMC central tendency projections

		2010	2011	2012	Longer Run
GDP	June	3.0 to 3.5	3.5 to 4.2	3.5 to 4.5	2.5 to 2.8
	April	3.2 to 3.7	3.4 to 4.5	3.5 to 4.5	2.5 to 2.8
Unemployment	June	9.2 to 9.5	8.3 to 8.7	7.1 to 7.5	5.0 to 5.3
	April	9.1 to 9.5	8.1 to 8.5	6.6 to 7.5	5.0 to 5.3
PCE inflation	June	1.0 to 1.1	1.1 to 1.6	1.0 to 1.7	1.7 to 2.0
	April	1.2 to 1.5	1.1 to 1.9	1.2 to 2.0	1.7 to 2.0
Core PCE	June	0.8 to 1.0	0.9 to 1.3	1.0 to 1.5	
	April	0.9 to 1.2	1.0 to 1.5	1.2 to 1.6	

Source: Federal Reserve

Senior Analyst

Signe Roed-Frederiksen
+45 45 12 82 29
sroe@danskebank.dk

Senior Analyst

Peter Passing Andersen
+45 45 13 70 19
pa@danskebank.dk

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This research report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority. The author of this report is Lars Christensen, Chief Analyst.

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