

## US: FOMC Starts Its 2012 Policy Cycle With A Surprise

- FOMC surprised the markets as the Fed changed its forward expectations of the Fed Funds Target Rate (FFTR) unchanged at 0-0.25% “at least thorough late 2014” a significant extension from the previous “at least through mid-2013”
- The reaffirmed the easing measures announced in the FOMC statements in August and September (including the Twist Operation), and did not add new easing measures even though reiterated its willingness to do more for the US economy
- Even as the US economic and jobs outlook continued to show improvement going into 2012, the Fed remains concerned about the sustainability of the recovery and emphasized on the downside risks for the US due to the problems in Europe, weaker global growth and other factors
- We continue to expect the Fed to announce more easing measures in 1Q-2012 possibly with a QE3 programme that is centred on purchasing mortgage-back securities

In the first FOMC policy meeting of 2012, the Federal Open Market Committee (FOMC) surprisingly announced that it would **“keep the target range for the federal funds rate at 0 to 1/4 percent... at least through late 2014”** a significant extension from the previous expectation of **“through mid-2013”**. The FOMC also reaffirmed its commitment to its Twist Operation (of extending Fed’s holdings of securities as announced in September) and its policies of **“reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction.”**

The Fed also lowered their 2012 growth and inflation forecasts, and it announced an explicit long term inflation target of 2% (which refers to the y/y growth of the Personal Consumption Expenditure (PCE) Index). The Fed did not specify a fixed unemployment target rate as it is viewed **“determined by nonmonetary factors that may affect the structure and dynamics of the labor market”** although the FOMC participants had estimated the longer term unemployment normal rate to be 5.2-6.0%. Voting in the January FOMC meeting was not unanimous as Fed President Jeffrey M. Lacker (Richmond) dissented as he **“preferred to omit the description of the time period over which economic conditions are likely to warrant exceptionally low levels of the federal funds rate.”**

While no further new easing measures to stimulate the economy were announced, the FOMC **“is prepared to adjust those holdings [of securities] as appropriate to promote a stronger economic recovery in a context of price stability.”** In the news conference after the FOMC policy statement release, Fed Chairman Ben Bernanke said that the Fed is **“prepared to provide further monetary accommodation if employment is not making sufficient progress towards our assessment of its maximum level, or if inflation shows signs of moving further below its mandate-consistent rate”** and more bond purchases is **“an option that’s certainly on the table.”** While recent economic data from manufacturing, housing and labour markets suggested the economic recovery was improving further going into 2012, Bernanke remained cautious and is **“not ready to declare that we’ve entered a new stronger phase”** for the U.S. economy, citing downside risks from Europe, weaker global growth outlook and other factors.

Some of the key takeaways from the first FOMC were the significant extension of the forward guidance in holding the FFTR at the present ultralow rates till late 2014 and the explicit mention by Benanke that the extension of the expected point for any interest rates hikes implies that asset sales by the Fed would occur only presumably in 2015. The other significant key point was the downgrade of 2012 growth (to 2.2-2.7% from 2.5-2.9% previously) and 2012 inflation to be below the announced long-term target of 2% (core PCE inflation projected at 1.5-1.8% from 1.5-2.0% previously). And while there was no explicit mention of QE3, we believe that the weaker growth outlook and more subdued inflation expectation, still makes it possible for the Fed to announce more quantitative easing in 1Q-2012. As we mentioned in earlier reports, we believe the Fed could still be preparing for another round of significant asset buying programme and this time round it could be centred on mortgage-backed securities because US housing market remains in the doldrums and the depressed US house prices remain a significant problem hampering for the US economic recovery. A cut in the interest paid on bank's excess reserves held with Fed is also another easing policy option that may be utilized in 2012. That said, if the US economic data continue to improve robustly while the European debt situation finds stability, then the bar will definitely be raised before the Fed can justify introducing more QE.

<b>Economic Projections of US Federal Reserve Board, January 2012</b>				
Variable	Central Tendency (%)			
	2012	2013	2014	Longer Run
<b>Change in real GDP</b>	<b>2.2 - 2.7</b>	<b>2.8 - 3.2</b>	<b>3.3 - 4.0</b>	<b>2.3 - 2.6</b>
November 2011 projection	2.5 - 2.9	3.0 - 3.5	3.0 - 3.9	2.4 - 2.7
June 2011 projection	3.3 - 3.7	3.5 - 4.2		2.5 - 2.8
April 2011 projection	3.5 - 4.2	3.5 - 4.3		2.5 - 2.8
January 2011 projection	3.5 - 4.4	3.7 - 4.6		2.5 - 2.8
<b>Unemployment rate</b>	<b>8.2 - 8.5</b>	<b>7.4 - 8.1</b>	<b>6.7 - 7.6</b>	<b>5.2 - 6.0</b>
November 2011 projection	8.5 - 8.7	7.8 - 8.2	6.8 - 7.7	5.2 - 6.0
June 2011 projection	7.8 - 8.2	7.0 - 7.5		5.2 - 5.6
April 2011 projection	7.6 - 7.9	6.8 - 7.2		5.2 - 5.6
January 2011 projection	7.6 - 8.1	6.8 - 7.2		5.0 - 6.0
<b>PCE inflation</b>	<b>1.4 - 1.8</b>	<b>1.4 - 2.0</b>	<b>1.6 - 2.0</b>	<b>2.0</b>
November 2011 projection	1.4 - 2.0	1.5 - 2.0	1.5 - 2.0	1.7 - 2.0
June 2011 projection	1.5 - 2.0	1.5 - 2.0		1.7 - 2.0
April 2011 projection	1.2 - 2.0	1.4 - 2.0		1.7 - 2.0
January 2011 projection	1.0 - 1.9	1.2 - 2.0		1.6 - 2.0
<b>Core PCE inflation</b>	<b>1.5 - 1.8</b>	<b>1.5 - 2.0</b>	<b>1.6 - 2.0</b>	
November 2011 projection	1.5 - 2.0	1.4 - 1.9	1.5 - 2.0	
June 2011 projection	1.4 - 2.0	1.4 - 2.0		
April 2011 projection	1.3 - 1.8	1.4 - 2.0		
January 2011 projection	1.0 - 1.5	1.2 - 2.0		

Source: Federal Reserve

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