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First Trust

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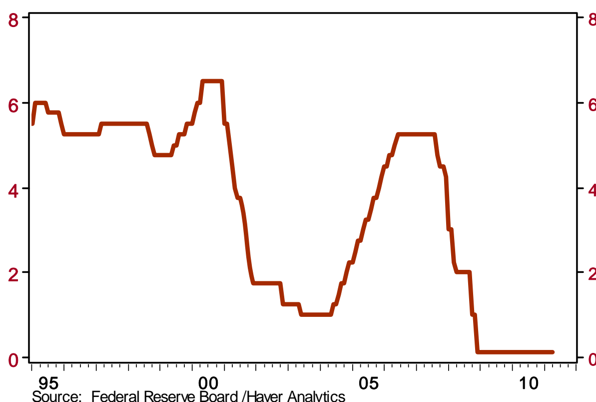
Economic Commentary

Minor Changes to Official Statement, More News in Press Conference

Today's official statement from the Federal Reserve included minimal changes from its last statement back in mid-March. The minor changes included a slightly better assessment of economic growth and more language recognizing higher headline inflation.

On the economy, the Fed said recent information "indicates that the economic recovery is proceeding at a moderate pace." This is a slight upgrade from saying the data "suggest that the economic recovery is on a firmer footing." In addition, the Fed said labor market conditions "*are* improving gradually," an upgrade from the March language that these conditions "*appear to be* improving gradually."

On inflation, the Fed prefaced its sentence about stable long-term inflation expectations and subdued underlying inflation by adding a simple declaration that "inflation has picked up in recent months."



On the second round of quantitative easing, the Fed made it clear it will fulfill its original pledge to buy $600 billion in long-term Treasury securities by mid-year, with no plans to curtail the program early or extend it further. Going forward, the Fed will review the size and composition of the massive balance sheet it has already accumulated, suggesting that without a formal change in policy it's committed to keeping the balance sheet steady, reinvesting the cash from maturing securities.

Otherwise, as everyone expected, the Fed made no direct changes to the stance of monetary policy today, leaving the target range for the federal funds rate at 0% to 0.25%. In addition, the Fed maintained its pledge to keep the funds rate at this level for an "extended period."

Of course, the big news today wasn't the official statement but the fact that for the first time in history the Chairman held a press conference after the meeting. We saw two significant takeaways in that event on how the Fed will conduct monetary policy.

First, Bernanke made it clear that he views ending the reinvestment of maturing securities as a form of tightening monetary policy. As a result, we think this is likely to happen – the end of the rollover of maturing debt – before the Fed starts formally raising short-term interest rates.

Second, the Fed believes the commitment to maintain essentially zero percent short-term interest rates for an "extended period" means for at least the next couple of Fed meetings, or roughly a three month time frame. In other words, the Fed will not start raising short-term rates until at least two meetings after it removes the "extended period" language from its statement.

In our view, the economy is already in the position to handle higher short-term rates. But we are obviously not in charge. Deciphering Bernanke's comments suggests the Fed will not start raising rates until at least 2012, perhaps much later than that. Higher inflation – and not just for commodities – will be the inevitable result.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Senior Economist*

Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in March indicates that the economic recovery is proceeding at a moderate pace and overall conditions in the labor market 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 last summer, and concerns about global supplies of crude oil have contributed to a further increase in oil prices since the Committee met in March. Inflation has

picked up in recent months, but longer-term inflation expectations have remained stable and measures of underlying inflation are still subdued.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. 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. Increases in the prices of energy and other commodities 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 will complete purchases of $600 billion of longer-term Treasury securities by the end of the current quarter. The Committee will regularly review the size and composition of its securities holdings in light of incoming information and is prepared to adjust 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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