



FEDERAL RESERVE

Securities purchases begin 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 is reducing its monthly securities purchases by US\$10B. In January, it will acquire US\$35B in mortgage securities (instead of US\$40B) and US\$40B in Treasuries (instead of US\$45B).
- 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.
- Information received since the Federal Open Market Committee met in October indicates that economic activity is expanding at a moderate pace. Labor market conditions have shown further improvement; the unemployment rate has declined but remains elevated. Household spending and business fixed investment advanced, while the recovery in the housing sector slowed somewhat in recent months. Fiscal policy is restraining economic growth, although the extent of restraint may be 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

After months of speculation that captured almost all of the financial markets' attention, the Fed announced today that it would begin to taper its securities purchases in January. Note that in December 2012, the Fed had decided to purchase US\$85B in securities for an indefinite period. This pace of quantitative easing will have therefore lasted for one year. Markets initially expected a first reduction in September, but less conclusive economic data and the imminent budget impasse made the Fed wait three months longer. Better

economic data, including employment, and the bipartisan agreement that reduces risk of further partisan conflict over budget policy prompted the Fed to act immediately.

At the post-meeting press conference, Ben Bernanke mentioned that securities purchases should normally be withdrawn at a moderate speed. A US\$10B reduction at each meeting seems compatible with this pace. The third wave of quantitative easing would therefore end in late 2014. This still depends on how economic indicators move.

In terms of economic forecasts, Fed leaders have hardly changed their expectations for GDP growth. However, they expect a faster drop by the jobless rate, of around 0.1 to 0.2 percentage points for each year between now and 2016. The 6.5% threshold should therefore be reached at the end of 2014 or the start of 2015. Inflation forecasts have also been trimmed.

A vast majority of Fed leaders expect a first rate hike in 2015. However, the median forecast for key rates at the end of 2015 is now 0.75%, instead of 1.00% as at the September meeting, thus implying that just two rate increases will occur. Four rate hikes are expected in 2016, bringing the anticipated rate up to 1.75%. At first glance, these predictions are not compatible with reaching the 6.50% jobless rate threshold earlier than expected. However, Fed leaders clearly stated that they would wait until well after this threshold is reached to start raising rates. It remains to be seen if a full year is justifiable. The Fed, led by Janet Yellen as of February, could still decide to lower its threshold for the jobless rate.

Implications: Securities purchases have begun to wind down and should continue at the same pace—US\$10B per meeting—from now until the end of the year. We do not expect key rates to go up 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.

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Schedule 2013 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>		
JANUARY			JULY				
10	European Central Bank	s.q.	0.75	2	Reserve Bank of Australia	s.q.	2.75
10	Bank of England	s.q.	0.50	3	Bank of Sweden	s.q.	1.00
16	Bank of Brazil	s.q.	7.25	4	European Central Bank	s.q.	0.50
18	Bank of Mexico	s.q.	4.50	4	Bank of England	s.q.	0.50
21	Bank of Japan	s.q.	0.10	10	Bank of Brazil	+50 b.p.	8.50
23	Bank of Canada	s.q.	1.00	11	Bank of Japan	s.q.	0.10
30	Reserve Bank of New Zealand	s.q.	2.50	12	Bank of Mexico	s.q.	4.00
30	Federal Reserve	s.q.	0.25	17	Bank of Canada	s.q.	1.00
FEBRUARY			AUGUST				
4	Reserve Bank of Australia	s.q.	3.00	1	European Central Bank	s.q.	0.50
7	European Central Bank	s.q.	0.75	1	Bank of England	s.q.	0.50
7	Bank of England	s.q.	0.50	6	Reserve Bank of Australia	-25 b.p.	2.50
13	Bank of Sweden	s.q.	1.00	8	Bank of Japan	s.q.	0.10
13	Bank of Japan	s.q.	0.10	28	Bank of Brazil	+50 b.p.	9.00
MARCH			SEPTEMBER				
4	Reserve Bank of Australia	s.q.	3.00	3	Reserve Bank of Australia	s.q.	2.50
6	Bank of Brazil	s.q.	7.25	4	Bank of Canada	s.q.	1.00
6	Bank of Canada	s.q.	1.00	5	European Central Bank	s.q.	0.50
6	Bank of Japan	s.q.	0.10	5	Bank of England	s.q.	0.50
7	European Central Bank	s.q.	0.75	5	Bank of Sweden	s.q.	1.00
7	Bank of England	s.q.	0.50	5	Bank of Japan	s.q.	0.10
8	Bank of Mexico	-50 b.p.	4.00	6	Bank of Mexico	-25 b.p.	3.75
13	Reserve Bank of New Zealand	s.q.	2.50	11	Reserve Bank of New Zealand	s.q.	2.50
14	Bank of Norway	s.q.	1.50	18	Federal Reserve	s.q.	0.25
14	Swiss National Bank	s.q.	0.00	19	Bank of Norway	s.q.	1.50
20	Federal Reserve	s.q.	0.25	19	Swiss National Bank	s.q.	0.00
APRIL			OCTOBER				
1	Reserve Bank of Australia	s.q.	3.00	1	Reserve Bank of Australia	s.q.	2.50
4	European Central Bank	s.q.	0.75	2	European Central Bank	s.q.	0.50
4	Bank of England	s.q.	0.50	4	Bank of Japan	s.q.	0.10
4	Bank of Japan	s.q.	0.10	9	Bank of Brazil	+50 b.p.	9.50
17	Bank of Sweden	s.q.	1.00	10	Bank of England	s.q.	0.50
17	Bank of Brazil	+25 b.p.	7.50	23	Bank of Canada	s.q.	1.00
17	Bank of Canada	s.q.	1.00	24	Bank of Norway	s.q.	1.50
23	Reserve Bank of New Zealand	s.q.	2.50	24	Bank of Sweden	s.q.	1.00
26	Bank of Japan	s.q.	0.10	25	Bank of Mexico	-25 b.p.	3.50
26	Bank of Mexico	s.q.	4.00	30	Reserve Bank of New Zealand	s.q.	2.50
MAY			NOVEMBER				
1	Federal Reserve	s.q.	0.25	4	Reserve Bank of Australia	s.q.	2.50
2	European Central Bank	-25 b.p.	0.50	7	European Central Bank	-25 b.p.	0.25
7	Reserve Bank of Australia	-25 b.p.	2.75	7	Bank of England	s.q.	0.50
8	Bank of Norway	s.q.	1.50	21	Bank of Japan	s.q.	0.10
9	Bank of England	s.q.	0.50	27	Bank of Brazil	+50 b.p.	10.00
22	Bank of Japan	s.q.	0.10	DECEMBER			
29	Bank of Brazil	+50 b.p.	8.00	2	Reserve Bank of Australia	s.q.	2.50
29	Bank of Canada	s.q.	1.00	4	Bank of Canada	s.q.	1.00
JUNE			NOVEMBER				
4	Reserve Bank of Australia	s.q.	2.75	5	European Central Bank	s.q.	0.25
6	European Central Bank	s.q.	0.50	5	Bank of England	s.q.	0.50
6	Bank of England	s.q.	0.50	5	Bank of Norway	s.q.	1.50
7	Bank of Mexico	s.q.	4.00	6	Bank of Mexico	s.q.	3.50
11	Bank of Japan	s.q.	0.10	11	Reserve Bank of New Zealand	s.q.	2.50
12	Reserve Bank of New Zealand	s.q.	2.50	12	Swiss National Bank	s.q.	0.00
19	Federal Reserve	s.q.	0.25	17	Bank of Sweden	-25 b.p.	0.75
20	Bank of Norway	s.q.	1.50	18	Federal Reserve	s.q.	0.25
20	Swiss National Bank	s.q.	0.00	20	Bank of Japan		