Essentials of the Monetary Policy

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FEDERAL RESERVE

Yellen and colleagues give themselves more flexibility

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 April, the Fed will purchase US$25B in mortgage-backed securities (instead of US$30B), and US$30B in Treasury securities (instead of US$35B).
- The Committee today reaffirmed its view that a highly accommodative stance of monetary policy remains appropriate. In determining how long to maintain the current target range, the Committee will assess progress—both realized and expected—toward its objectives.
- Growth in economic activity slowed during the winter months, in part reflecting adverse weather conditions. Labor market indicators were mixed but on balance showed further improvement. The unemployment rate, however, remains elevated. Household spending and business fixed investment continued to advance, while the recovery in the housing sector remained slow. 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 over the medium term.
- The Committee sees the risks to the outlook for the economy and the labor market as 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

The changes in the Fed's reading of the economic situation are not very surprising. Mention had to be made of the disappointment created by many economic indicators in recent months. However, it is increasingly clear that the setbacks were primarily caused by a very harsh winter. Therefore, despite weaker figures, the Fed made few alterations to its economic outlook compared with last December. For 2014, the forecast range for real GDP growth goes from between 2.8% and 3.2% to between 2.8% and 3.0%. The top of 2015's range was trimmed 0.2%, for a growth forecast between 3.0% and 3.2%. Simultaneously, the Fed lowered its projections for the jobless rate for 2014, 2015 and 2016. The inflation projections remain essentially the same as they were in December. As its picture of the U.S. economy has not changed much, it is normal for the Fed to continue tapering at the same pace as in December and January.

The main change to the statement accompanying Janet Yellen's first meeting as chair comes in the forward guidance that had been in place since December 2012. The previous conditional threshold for the jobless rate (6.5%) is no longer in force. Fed leaders have dropped this quantitative concept, replacing it with a vaguer concept that will "take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments." In the same breath, the statement notes that the federal funds rate will remain low for a considerable period and that the change of indicator does not affect the Fed's intentions. Here, the monetary policy committee members' own projections for key rates have only been slightly revised upwards: the median forecast puts rates at 1.00% at the end of 2014, implying that three increases are likely next year. For the end of 2016, the rate is projected to be 2.25%, pointing to five additional increases.

Implications: Today, Janet Yellen's Fed cast off the shackles imposed by quantitative thresholds. However, the policy is unchanged. As in our latest scenarios, we expect tapering to continue at this pace, with securities purchases dropping by US$10B at each meeting. 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.

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
21-22	Bank of Japan	---	---
22	Bank of Canada	s.q.	1.00
29	Reserve Bank of New Zealand	s.q.	2.50
29	Federal Reserve	s.q.	0.25
31	Bank of Mexico	s.q.	3.50
FEBRUARY			
3	Reserve Bank of Australia	s.q.	2.50
6	European Central Bank	s.q.	0.25
6	Bank of England	s.q.	0.50
13	Bank of Sweden	s.q.	0.75
17-18	Bank of Japan	---	---
26	Bank of Brazil	+25 b.p.	10.75
MARCH			
3	Reserve Bank of Australia	s.q.	2.50
5	Bank of Canada	s.q.	1.00
6	European Central Bank	s.q.	0.25
6	Bank of England	s.q.	0.50
10-11	Bank of Japan	---	---
12	Reserve Bank of New Zealand	+25 b.p.	2.75
19	Federal Reserve	s.q.	0.25
20	Swiss National Bank		
21	Bank of Mexico		
27	Bank of Norway		
31	Reserve Bank of Australia		
APRIL			
2	Bank of Brazil		
3	European Central Bank		
7-8	Bank of Japan		
9	Bank of Sweden		
10	Bank of England		
16	Bank of Canada		
23	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		
20-21	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		
11	Reserve Bank of New Zealand		
12-13	Bank of Japan		
18	Federal Reserve		
19	Bank of Norway		
19	Swiss National Bank		

		Decision	Rate
JULY			
1	Reserve Bank of Australia		
3	European Central Bank		
3	Bank of Sweden		
10	Bank of England		
11	Bank of Mexico		
14-15	Bank of Japan		
16	Bank of Brazil		
16	Bank of Canada		
23	Reserve Bank of New Zealand		
30	Federal Reserve		
AUGUST			
5	Reserve Bank of Australia		
7	European Central Bank		
7	Bank of England		
7-8	Bank of Japan		
SEPTEMBER			
2	Reserve Bank of Australia		
3	Bank of Brazil		
3	Bank of Canada		
3-4	Bank of Japan		
4	European Central Bank		
4	Bank of England		
4	Bank of Sweden		
5	Bank of Mexico		
10	Reserve Bank of New Zealand		
17	Federal Reserve		
18	Bank of Norway		
18	Swiss National Bank		
OCTOBER			
2	European Central Bank		
6	Reserve Bank of Australia		
6-7	Bank of Japan		
9	Bank of England		
22	Bank of Canada		
23	Bank of Norway		
28	Bank of Sweden		
29	Reserve Bank of New Zealand		
29	Bank of Brazil		
29	Federal Reserve		
31	Bank of Japan		
31	Bank of Mexico		
NOVEMBER			
3	Reserve Bank of Australia		
6	European Central Bank		
6	Bank of England		
18-19	Bank of Japan		
DECEMBER			
1	Reserve Bank of Australia		
3	Bank of Brazil		
3	Bank of Canada		
4	European Central Bank		
4	Bank of England		
5	Bank of Mexico		
10	Reserve Bank of New Zealand		
11	Bank of Norway		
11	Swiss National Bank		
16	Bank of Sweden		
17	Federal Reserve		
18-19	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.