

July 30, 2014



FEDERAL RESERVE

The Fed stays on course

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 August, the Fed will purchase US\$10B in mortgage-backed securities, and US\$15B in Treasury securities.
- The Committee continues to anticipate that it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends. 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 rebounded in the second quarter. Labor market conditions improved, with the unemployment rate declining further. However, a range of labor market indicators suggests that there remains significant underutilization of labor resources. Household spending appears to be rising moderately and business fixed investment is advancing, while the recovery in the housing sector remains slow.
- Inflation has moved somewhat closer to the Committee's longer-run objective. Longer-term inflation expectations have remained stable.
- The Committee sees the risks to the outlook for economic activity and the labor market as nearly balanced and judges that the likelihood of inflation running persistently below 2% has diminished somewhat. If incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings.

COMMENTS

No notable changes were expected in the Fed's July statement. A new \$US10B monthly reduction in the pace of monthly bond purchases was almost assured when Chair Janet Yellen recently confirmed that Fed leaders forecast ending the third quantitative easing program (QE3) after their October meeting.

As expected, the part of the Fed's statement about future monetary policy did not change. It did make some changes, however, to reflect the fact that the jobless rate and inflation have neared their long-term objectives. As the jobless rate fell to 6.1% in June, very close to the median level forecast by Fed leaders for the end of the year, the Fed removed from its statement the sentence stating that the jobless rate was still elevated. However it added that other job market indicators signalled that U.S. labour was still significantly underused.

Clearer is the change in tone on inflation. As the Fed was hoping, inflation moved much closer to its target in recent months. As such, the Fed removed the sentence stating that it would closely monitor price changes given the risk of lasting, unfavourably low inflation.

The dissent of the Philadelphia Fed President, who is no longer comfortable with signaling that the key rate will likely hold steady for a considerable period of time after QE3 is concluded, confirms that debates are heating up in the Fed. As the U.S. economy advanced toward the Fed's objectives at a good pace and the first estimate of GDP for the second quarter confirmed the rebound of U.S. activity, after the disappointing winter, the question of what is the appropriate time to start normalizing key rates is starting to be asked more seriously.

Implications: Despite one dissent, Fed leaders seem generally comfortable with the very low interest rates currently seen in the market. In this context, we continue to forecast that the Fed will not start raising the target range for the federal funds rate until the end of summer 2015. The probability of a tightening starting slightly sooner has nonetheless increased given the latest data on GDP and the job market.

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Schedule 2014 of Central Bank meetings

	<u>Decision</u>	<u>Rate</u>		<u>Decision</u>	<u>Rate</u>		
JANUARY			JULY				
9	European Central Bank	s.q.	0.25	1	Reserve Bank of Australia	s.q.	2.50
9	Bank of England	s.q.	0.50	3	European Central Bank	s.q.	0.15
15	Bank of Brazil	+50 b.p.	10.50	3	Bank of Sweden	-50 b.p.	0.25
21-22	Bank of Japan	---	---	10	Bank of England	s.q.	0.50
22	Bank of Canada	s.q.	1.00	11	Bank of Mexico	s.q.	3.00
29	Reserve Bank of New Zealand	s.q.	2.50	14-15	Bank of Japan	---	---
29	Federal Reserve	s.q.	0.25	16	Bank of Brazil	s.q.	11.00
31	Bank of Mexico	s.q.	3.50	16	Bank of Canada	s.q.	1.00
FEBRUARY			AUGUST				
3	Reserve Bank of Australia	s.q.	2.50	5	Reserve Bank of Australia		
6	European Central Bank	s.q.	0.25	7	European Central Bank		
6	Bank of England	s.q.	0.50	7	Bank of England		
13	Bank of Sweden	s.q.	0.75	7-8	Bank of Japan		
17-18	Bank of Japan	---	---	SEPTEMBER			
26	Bank of Brazil	+25 b.p.	10.75	2	Reserve Bank of Australia		
MARCH			OCTOBER				
3	Reserve Bank of Australia	s.q.	2.50	2	European Central Bank		
5	Bank of Canada	s.q.	1.00	6	Reserve Bank of Australia		
6	European Central Bank	s.q.	0.25	6-7	Bank of Japan		
6	Bank of England	s.q.	0.50	9	Bank of England		
10-11	Bank of Japan	---	---	22	Bank of Canada		
12	Reserve Bank of New Zealand	+25 b.p.	2.75	23	Bank of Norway		
19	Federal Reserve	s.q.	0.25	28	Bank of Sweden		
20	Swiss National Bank	s.q.	0.00	29	Reserve Bank of New Zealand		
21	Bank of Mexico	s.q.	3.50	29	Bank of Brazil		
27	Bank of Norway	s.q.	1.50	29	Federal Reserve		
31	Reserve Bank of Australia	s.q.	2.50	31	Bank of Japan		
APRIL			NOVEMBER				
2	Bank of Brazil	+25 b.p.	11.00	3	Reserve Bank of Australia		
3	European Central Bank	s.q.	0.25	6	European Central Bank		
7-8	Bank of Japan	---	---	6	Bank of England		
9	Bank of Sweden	s.q.	0.75	18-19	Bank of Japan		
10	Bank of England	s.q.	0.50	DECEMBER			
16	Bank of Canada	s.q.	1.00	1	Reserve Bank of Australia		
23	Reserve Bank of New Zealand	+25 b.p.	3.00	3	Bank of Brazil		
25	Bank of Mexico	s.q.	3.50	3	Bank of Canada		
30	Bank of Japan	---	---	4	European Central Bank		
30	Federal Reserve	s.q.	0.25	4	Bank of England		
MAY			NOVEMBER				
6	Reserve Bank of Australia	s.q.	2.50	5	Bank of Mexico		
8	European Central Bank	s.q.	0.25	10	Reserve Bank of New Zealand		
8	Bank of England	s.q.	0.50	11	Bank of Norway		
8	Bank of Norway	s.q.	1.50	11	Swiss National Bank		
20-21	Bank of Japan	---	---	16	Bank of Sweden		
28	Bank of Brazil	s.q.	11.00	17	Federal Reserve		
JUNE			NOVEMBER				
3	Reserve Bank of Australia	s.q.	2.50	18-19	Bank of Japan		
4	Bank of Canada	s.q.	1.00	DECEMBER			
5	European Central Bank	-10 b.p.	0.15	1	Reserve Bank of Australia		
5	Bank of England	s.q.	0.50	3	Bank of Brazil		
6	Bank of Mexico	-50 b.p.	3.00	3	Bank of Canada		
11	Reserve Bank of New Zealand	+25 b.p.	3.25	4	European Central Bank		
12-13	Bank of Japan	---	---	4	Bank of England		
18	Federal Reserve	s.q.	0.25	5	Bank of Mexico		
19	Bank of Norway	s.q.	1.50	10	Reserve Bank of New Zealand		
19	Swiss National Bank	s.q.	0.00	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.