



TD Economics

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Data Release: Fed extends commitment to keep rates low

- The Fed today extended its conditional commitment to keep its target rate at “exceptionally low levels” through at least late 2014. This marks a significant departure from the Fed’s previous commitment to keep rates on hold through mid-2013.
- The Committee recognized that the economy was “expanding moderately,” but that “some slowing in global growth” and “strains in global financial markets” posed “significant downside risks to the economic outlook”. It also noted that while household spending had advanced, growth in business investment had slowed, and the housing sector remains depressed.
- The Committee anticipates that inflation will continue to run at levels at or below those consistent with its mandate in the coming quarters, noting that the outlook for inflation remained “subdued” over the medium term.
- As it has done since September, the Fed will continue its program of extending the average maturity of its securities holdings. It will also continue reinvesting the principal payments from its holdings of agency debt and agency mortgage-backed securities (MBS) in additional MBS.
- Jeffrey Lacker was the sole dissenting voice to today’s announcement, preferring to omit the description of the time period over which economic conditions are likely to warrant exceptionally low levels of the federal funds rate.

Key Implications

- In extending its conditional commitment to keep rates “exceptionally low” for at least another year-and-a-half longer than previously announced, the Fed is injecting additional monetary stimulus into the economy – albeit in an unconventional way. Yields were down across the curve in the wake of the announcement.
- However, today’s monetary policy action is unlikely to be an economic game changer. Rates are already at historic lows, and the problem at this point isn’t so much the price of credit; it’s the demand for it. Over-indebted households are still in the process of deleveraging, and businesses have adopted a wait-and-see attitude towards new investment in the face of macroeconomic uncertainties. While today’s announcement should provide some push at the margin, it is unlikely to alter economic momentum in a significant way.
- In what represents a major change in its communication strategy, the Fed will publish its forecasts for the future path of interest rates later today. There is also some speculation that the Fed will move closer to formally encoding an inflation and unemployment rate target. The increase in transparency is meant to reduce interest rate volatility by giving markets a clearer sense of where the Fed sees rates heading over a 3-year timeframe. We will have more to discuss on this point once the projections are released, right before Chairman Bernanke’s press conference at 2:30 ET.

Chris Jones, Economist
416-983-0500

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