TD Economics

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Data Release: Federal Reserve holds the line on asset purchases, but signals reduced downside risk to economic outlook

- As expected, the Federal Open Market Committee (FOMC) made no change to its current asset purchase program. It will continue to purchase $45 billion per month in Treasury securities, $40 billion per month in mortgage backed securities (MBS), and will reinvest principal payments from its holdings of agency debt and MBS and rollover maturing Treasury securities.

- The statement's discussion of the economic outlook noted "further" improvement in labor market conditions (in place of "some" in the previous statement). The only other major change to the statement was that "the downside risks to the outlook for the economy and the labor market have diminished since the fall."

- Along with the statement, the FOMC released updated economic projections. The most notable changes were to the projections for unemployment and inflation. For 2014, the central tendency for the unemployment rate fell to a range of 6.5% to 6.9% (from 6.7% to 7.0%), and for 2015 to a range of 5.8% to 6.2% (from 6.0% to 6.5%). In terms of inflation, the central tendency for core inflation in 2013 fell to a range of 1.2% to 1.3% (from 1.5% to 1.6%), for 2014 it fell to a range of 1.5% to 1.8% (from 1.7% to 2.0% in March).

- The forecast for economic growth for 2013 reduced the top end of the range to 2.6% (from 2.8%) but was otherwise unchanged (central tendency of 2.3% to 2.6%). For 2014, the outlook for growth edged up 0.1 percentage points at both the low and high end of the central tendency (now 3.0% to 3.5% from 2.9% to 3.4% previously), but was little changed thereafter.

Key Implications

- While the Fed may not be quite ready to begin tapering its asset purchases yet, it is moving solidly in that direction. The statement should do little to change the market perception that the Fed is signaling its intentions to taper its asset purchases later this year.

- The change in language regarding the reduced risk to the economic outlook in combination with a lower forecast for the unemployment rate imply that the Fed is increasingly confident that the private sector will shake off the drag from fiscal policy. The reduction in the outlook for inflation is in recognition of recent trends, but does not change the calculus for the Fed. Importantly, inflation is expected to have reached a nadir this year and will move towards the Fed's target over the next two.

- More details about the Fed's exit strategy are likely to be communicated by Chairman Bernanke in his upcoming press conference. Stay tuned for more commentary following his remarks.

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