ECONOMIC UPDATE

REGIONS

May 1, 2013

May FOMC Meeting: No Changes In Policy . . . Just Yet

- As expected, the FOMC announced no changes to current Fed policy and offered no additional guidance as the timing of any future changes.
- The FOMC's post meeting policy statement includes an explicit reference to fiscal policy restraining economic growth.

As anticipated, the April 30/May 1 FOMC meeting resulted in no changes to current Fed policy and no additional guidance around the timing of any future policy changes. The FOMC did, however, acknowledge the prospect of changes to the pace of asset purchases depending on the evolution of the outlook for the labor market or inflation, noting that the pace of purchases could increase or decrease.

The Committee's assessment of current economic conditions was little changed, with economic growth again characterized as "moderate." By noting that "labor market conditions have shown some improvement in recent months, on balance" the Committee acknowledged the uneven pace of improvement in labor market conditions while further noting that the unemployment rate remains elevated. Whereas the March statement noted that fiscal policy had become somewhat more restrictive, today's statement goes further, with fiscal policy now said to be "restraining economic growth."

The only other material change to the post meeting policy statement is the addition of the following sentence: "The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or the labor market changes." This could prove to be a very versatile sentence. Note that over the past several weeks there had been much discussion, both inside and outside of the Fed, of when and to what extent the FOMC would decide to pare down the pace of asset purchases. Indeed, in his post meeting press conference in March, Chairman Bernanke discussed how asset purchases would be pared down before they were ended, and noted the difficulties involved in offering guidance on any such change.

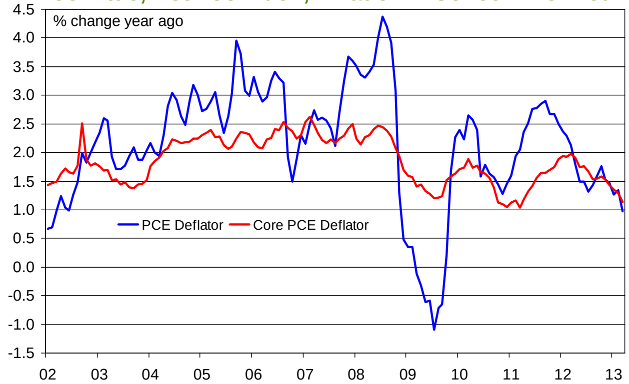
With today's statement, however, the Committee holds open the possibility that the pace of asset purchases could be stepped up if need be. This could be an acknowledgement that some FOMC members are increasingly worried about the recent bout of disinflation, or that some FOMC members feel that the downward drift in the rate of inflation gives the Fed cover to increase the rate of asset purchases to add some fuel to the recovery in the labor market and the broader economy. On this point, the release of the minutes to today's meeting in three weeks should be instructive.

It is also possible that the inclusion of this new sentence reflects some uncertainty within the FOMC over the correct interpretation of the recent economic data, a feeling with which those of us outside the FOMC know all too well. In other words, is the economy going through yet another spring swoon, or is the softer tone of the data of late reflecting the impact of tighter fiscal policy, an impact that should gradually fade as we move through 2013 and into 2014. By allowing for the pace of asset purchases to be either increased or reduced, as warranted, the Committee could be signaling the markets that it is simply too soon to make this call. The addition of this sentence to the post meeting statement could help account for why the assessment of current conditions was not softer despite what has been a rash of disappointing data of late.

We think it unlikely that the Fed would increase the rate of asset purchases. First, in terms of effectiveness, with growth in the asset side of the Fed's balance sheet to a large extent negated by growth in excess reserves, it is a valid question as to what could be accomplished by the Fed buying more assets. Second, to the extent the value of the Fed's policy lies in signaling the Fed's commitment to ensuring the recovery strengthens, as opposed to actually pushing more money into the economy, there are other options, such as lowering the unemployment rate threshold or increasing the inflation threshold the FOMC previously set as markers for any change in asset purchases. These are the types of issues the FOMC is currently grappling with and the Committee is not yet at the point where they can tip their hand, let alone make an actual change in policy. Our view remains that tapering is the more likely outcome, though any such change may not come until early 2014 instead of late 2013 as we had previously expected.

REGIONS

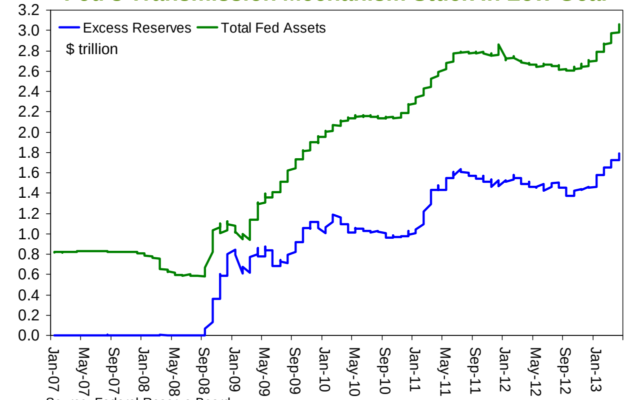
Too Little, Not Too Much, Inflation A Concern For Fed?



Source: Bureau of Labor Statistics

REGIONS

Fed's Transmission Mechanism Stuck In Low Gear



Source: Federal Reserve Board

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com