

June 18, 2014



FEDERAL RESERVE

The Fed downgrades its growth forecast

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 May, the Fed will purchase US\$15B in mortgage-backed securities, and US\$20B 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 has rebounded in recent months. Labor market indicators generally showed further improvement. The unemployment rate, though lower, remains elevated. Household spending appears to be rising moderately and business fixed investment resumed its 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.

COMMENTS

Fed leaders are staying the course despite the economic situation's ups and downs since the beginning of the year. Once again, they made very few changes in the statement accompanying today's meeting. Janet Yellen and her colleagues particularly focused on the rebound in growth observed since real GDP's disappointing 1% contraction in the first quarter.

Despite the expectations for a turnaround, the Fed, like most forecasters, had to downgrade its economic growth projections for 2014. The band for the annual change in real GDP forecast for the end of 2014 is revised from

2.8%–3.0% to 2.1%–2.3%. The band for 2015 remains unchanged, at 3.0%–3.2%. Even with weaker growth, the Fed forecasts a lower jobless rate for 2014 and 2015. In addition, the Fed's forecast of inflation rates were very slightly increased. However, these changes should be read more as the effect of data released since March than as a real change in expectations.

At the same time, there was a small change in the Fed leaders' own expectations on key rates. The federal funds rate median forecast for the end of 2015 was revised from 1.00% to 1.00%–1.25%, while the median for the end of 2016 went from 2.25% to 2.50%. In contrast, the median for the long-term forecast was reduced from 4.00% to 3.75%. These small changes might mean that the Fed could start raising rates one meeting earlier, but keep them lower thereafter. However, Janet Yellen warned in the press conference not to jump too quickly to this kind of conclusion, especially since there have been recent staffing changes on the monetary policy committee.

The Fed finds itself in the dilemma of weaker-than-anticipated economic growth diverging from slightly quicker inflation and an improving job market. The situation is manageable for the moment. However, later it could cause even more divergence within the monetary policy committee and add to uncertainties in the markets. The upcoming decisions may be hard to make, and Janet Yellen would probably like to calm rate hike expectations if economic growth rebounds.

Implications: The Fed is staying the course and tapering of securities purchases should continue at the same pace until they are reduced to zero in the fall. We do not anticipate any rise in key rates before September 2015.

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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 | |
| 9 | Bank of England | s.q. | 0.50 | 3 | European Central Bank | |
| 15 | Bank of Brazil | +50 b.p. | 10.50 | 3 | Bank of Sweden | |
| 21-22 | Bank of Japan | --- | --- | 10 | Bank of England | |
| 22 | Bank of Canada | s.q. | 1.00 | 11 | Bank of Mexico | |
| 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 | |
| 31 | Bank of Mexico | s.q. | 3.50 | 16 | Bank of Canada | |
| 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. | 1.50 | 11 | Bank of Norway | |

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.