Deutsche Bank

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DATA FLASH (US)

Economics

Minutes hint of possible further easing

The minutes of the August 9 FOMC meeting suggested that most policymakers were revising down their growth forecasts for 2011 and 2012, and in turn some were downgrading their inflation assessment, as well. Similar to the tone of the actual FOMC statement, participants acknowledged that economic growth was "considerably slower than they had expected" and transitory headwinds "could account for only some of the [recent] weakness". Clearly, policymakers were eyeing downside risks to the outlook. We are somewhat surprised by the dovish outlook for inflation, as the minutes noted: "[A]s prices of energy and some commodities have declined from their earlier peaks, headline inflation has moderated." This is a questionable assumption given that headline CPI accelerated to 3.6% year-on-year in July from an average of 3.3% in Q2 and 2.2% in Q1. Similarly, the PPI stages of production also show mounting pressures: crude-stage (22.2% vs. 25.5%), intermediate-stage (11.8%—cyclical high) and finished-stage (7.2%—cyclical high). We were surprised to see the minutes note the following: "Participants generally noted that […] inflation was likely to decline somewhat over time."

In terms of the discussion of plausible policy tools, there were no major surprises. The usual options of QE3, maturity extension of the balance sheet and lowering interest on reserves were all cited. There was some discussion of tying the Fed's policy stance to various inflation or employment metrics, although the minutes suggest there was lukewarm support for such a measure. Policymakers did agree to make the September FOMC meeting a two-day event in order to provide more time to perform a cost-benefit analysis of the various tools remaining. At the current point in time, we believe that maturity extension is the most likely next step for the Fed because it would reduce longer term rates (flattening the curve) without expanding the Fed's balance sheet (i.e. "printing money"). However, we do not anticipate this to be implemented at the September FOMC—barring an extreme deterioration in the economic data over the next three weeks. Instead, we think the November meeting would be more suitable, as it would provide more time for policymakers to determine if output growth and inflation were indeed faltering.

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