



International Outlook

A PUBLICATION FROM GPS CAPITAL MARKETS, CORPORATE FOREIGN EXCHANGE DIVISION

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FOMC Meeting



By David Pierce
Director Business Development

Did the FOMC Just Slam the Dollar!?

By David Pierce, Director Business Development

The news out of the Federal Open Market Committee meeting today was not the news USD advocates had been looking for. In fact, the news has troubling connotations for both the near and longer term outlook for the dollar. Consider that the dollar has strengthened over 8% this year against a trade weighted basket of world currencies. Combine this with a look at the current Purchasing Power Parity, and the dollar looked like hit still had plenty of room for strength. The current PPP shows AUD overvalued by 27%, and the Euro by 14%, but the FED changed all that in a moment.

What did the FOMC say, and what does it mean?

At first blush, the news seemed quite mundane, for instance the Fed's assessment of the economy has not changed much since the August FOMC meeting. But when discussing the Fed's interest rate bias, they changed their direction and state that they will work to ease interest rates further. This is basically an attempt by the FED to alert the markets that further attempts to undermine the value of the USD will be forthcoming.

Additionally the FED had some very strongly worded sentiment on inflation, and their direction in dealing with it. Basically, the Fed believes that we do NOT have enough inflation, and it is currently at levels that the FED considers "at levels somewhat below those the Committee judges most consistent, over the longer run, with its mandate to promote maximum employment and price stability." This sent a strong signal to the market that we are entering a period of definitive easing bias and leaves the door wide open to further easing throughout the end of the year.

Quick Comparison of the last 2 FOMC Statements.

Economy:

Statement from Sep 21, 2010

"...the pace of recovery in output and employment has slowed in recent months. Household spending is increasing gradually, but

Corporate Headquarters:

10813 River Front Pkwy, Ste. 410
South Jordan, UT 84095

800-459-8181

www.GPSFx.com



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remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, though less rapidly than earlier in the year, while investment in nonresidential structures continues to be weak. Employers remain reluctant to add to payrolls. Housing starts are at a depressed level. Bank lending has continued to contract, but at a reduced rate in recent months."

Statement from Aug 10, 2010:

"...the pace of recovery in output and employment has slowed in recent months. Household spending is increasing gradually, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising; however, investment in nonresidential structures continues to be weak and employers remain reluctant to add to payrolls. Housing starts remain at a depressed level. Bank lending has continued to contract."

Inflation:

Statement from Sep 21, 2010

"Measures of underlying inflation are currently at levels somewhat below those the Committee judges most consistent, over the longer run, with its mandate to promote maximum employment and price stability. With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to remain subdued for some time before rising to levels the Committee considers consistent with its mandate."

Statement from Aug 10, 2010:

"Measures of underlying inflation have trended lower in recent quarters and, with substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time."

Interest Rates:

Statement from Sep 21, 2010

"The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period."

Statement from Aug 10, 2010:

"The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period."