

## Economic Analysis

# FOMC Minutes: Discussion on Tapering, Rate Hike, and Exit Strategy

Kim Fraser Chase

Details from the June FOMC meeting minutes were on par with our expectations regarding the ongoing pace of tapering and the communication surrounding future monetary policy accommodation. First and foremost, the minutes were straightforward in divulging the plan for tapering, noting that the final reduction of \$15bn could be announced in the October meeting (pending any significant changes to incoming economic data) rather than prolonging the process for the remaining \$5bn to be cut in December. The recent bout of positive employment data has again brought about questions on the timing of the first federal funds rate hike and whether this could occur much sooner than currently anticipated. However, the FOMC discussion did not hint at any change at this point, and we therefore maintain our expectations for the first hike in mid-2015.

There was no clear path outlined but it seems as though Committee members are at least moving closer towards a more common ideology when it comes to an exit strategy. One of the challenges facing the FOMC is to determine what will compose the core of the Committee's operating framework and communication during the normalization process. Individual member opinions on the subject diverge with the majority agreeing that the fed funds rate should continue to play a central role in FOMC communication. However, a few participants suggested that the "administered rate" may be a better tool to communicate monetary policy during the normalization period. In addition, the FOMC assessed possibilities for changing the calculation of the effective fed funds rate in a way that would be helpful to obtain a more robust measure of overnight bank funding rates. For more details, please refer to our latest [Fed Watch](#).

## JOLTS Data Point to Continued Strength in Labor Market Outlook

The latest JOLTS reports have become particularly relevant as the Fed looks to closely monitor labor market indicators other than the usual nonfarm payrolls and unemployment rate. Despite the fact that the report is delayed an extra month from the regular employment releases, we are beginning to see more consistent signs of a stronger labor market outlook moving forward. Job openings in May increased 3.8% to 4635K following an even bigger jump in the month prior and finally reaching peak levels seen before the recession. This is an encouraging signal that businesses are willing to expand their workforce in the near future. However, the number of actual hires has recovered only halfway to the pre-crisis peak, and the JOLTS report noted a -1.0% decline in hires for May. This is an important indicator to look at, particularly when it comes to the growing gap between job openings and hires. Fed Chair Janet Yellen has been extremely persistent in her argument that the faster-than-expected declines in the unemployment rate do not completely offset the issues that arise from this growing gap. As the FOMC moves closer to the first federal funds rate hike, we may see even further emphasis on these JOLTS releases in upcoming meeting discussions and related Fed speak.

## Week Ahead

### Retail Sales, Ex Auto (June, Tuesday 8:30 ET)

Forecast: 0.4%, 0.2%

Consensus: 0.6%, 0.5%

Previous: 0.3%, 0.0%

Expectations for retail sales growth in June are modest following a slower-than-expected performance in May. Reports from the weekly retail sales surveys are mixed and do not tell a consistent story for the month of June, with sales coming in quite volatile from week to week. However, the third consecutive monthly gain in unit auto sales at least points to a brighter picture for headline retail sales. Furthermore, another month of rising gas prices will surely put upward pressure on nominal sales from gasoline stations nationwide.

### Business Inventories (May, Tuesday 10:00 ET)

Forecast: 0.4%

Consensus: 0.6%

Previous: 0.6%

Business inventories in May are expected to continue on a 12-month upward trend, though at a slightly slower pace than in April. Wholesale inventory growth has been particularly strong in recent months, increasing 1.0% in March and April and another 0.5% in May. This should contribute to another steady increase for total inventories for the month, along with further gains from the retail and manufacturer sides as well. Moving forward, businesses should continue to build up stock in order to keep up with growing demand in a strengthening economy.

### Industrial Production (June, Wednesday 9:15 ET)

Forecast: 0.4%

Consensus: 0.3%

Previous: 0.6%

Industrial production has been moving along at an accelerated pace throughout most of 2014, and we expect that the gains will continue in June after a healthy rebound in May from the prior month's modest decline. The national ISM index and various regional Federal Reserve surveys point to steady growth in manufacturing production for the month of June. We also expect to see continued growth in mining activity, which has been positive throughout the past seven months. Although output from electric and gas utilities has been weighing on the overall index, it is unlikely that this will offset the more positive gains coming from the other major components of total industrial production.

### Consumer Sentiment (July, Friday 9:55 ET)

Forecast: 83.1

Consensus: 83.0

Previous: 82.5

Consumer views on the economy have been trending higher since a dip in late 2013. The latest gains in the consumer sentiment index have been driven by improvement in both expectations and views on current economic conditions. Recent data has suggested an increase in consumers' willingness to spend and take on additional debt, all of which point to an overall boost in economic confidence. For July, we expect to see continued growth in the overall index, particularly due to healthier labor market conditions and stronger prospects for income growth.

### Market Impact

This week's economic calendar is full of important indicators that could potentially send markets running one way or another. Many of the data releases could have a significant impact on GDP forecasts for 2Q, including retail sales, industrial production, and housing starts. Now that we are almost through 2Q data releases, markets should feel a bit more confident that the 1Q contraction was merely a one-off event.

**Economic Trends**

Graph 3  
**BBVA US Weekly Activity Index (3 month % change)**



Source: BBVA Research

Graph 4  
**BBVA US Monthly Activity Index & Real GDP (4Q % change)**



Source: BBVA Research & BEA

Graph 5  
**BBVA US Surprise Inflation Index (Index 2009=100)**



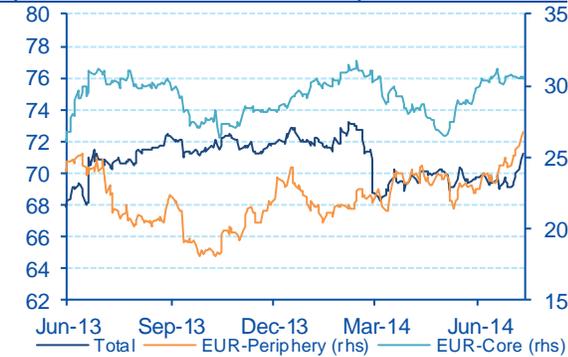
Source: BBVA Research

Graph 6  
**BBVA US Surprise Activity Index & 10-yr Treasury (Index 2009=100 & %)**



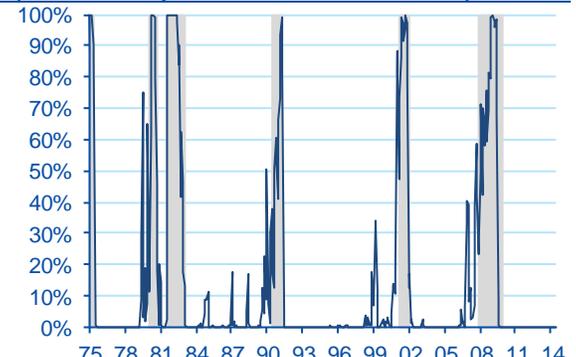
Source: Bloomberg & BBVA Research

Graph 7  
**Equity Spillover Impact on US (% Real Return Co-Movements)**



Source: BBVA Research

Graph 8  
**BBVA US Recession Probability Model (Recession episodes in shaded areas, %)**



Source: BBVA Research

**Financial Markets**

**Graph 9**  
**Stocks**  
**(Index, KBW)**



Source: Bloomberg & BBVA Research

**Graph 10**  
**Volatility & High-Volatility CDS**  
**(Indices)**



Source: Bloomberg & BBVA Research

**Graph 11**  
**Option Volatility & Real Treasury**  
**(52-week avg. change)**



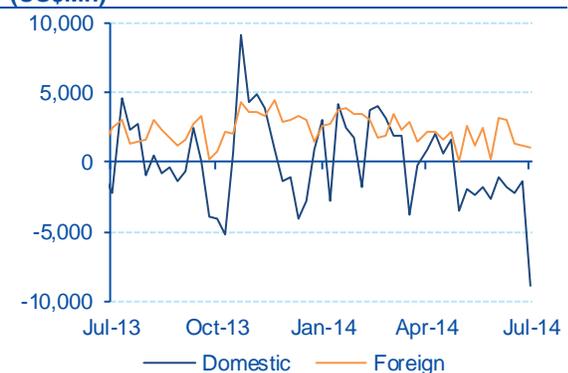
Source: Haver Analytics & BBVA Research

**Graph 12**  
**TED & BAA Spreads**  
**(%)**



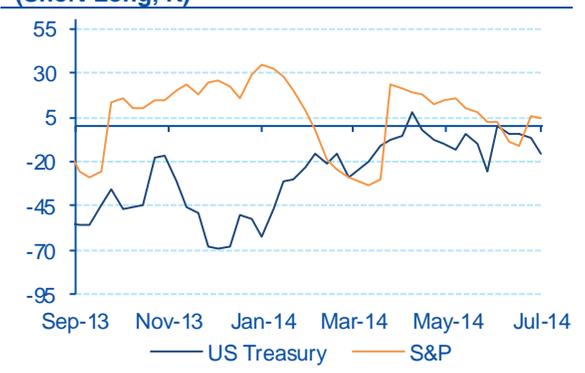
Source: Bloomberg & BBVA Research

**Graph 13**  
**Long-Term Mutual Fund Flows**  
**(US\$Mn)**



Source: Haver Analytics & BBVA Research

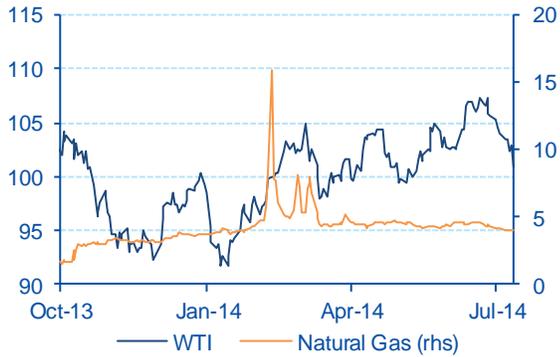
**Graph 14**  
**Total Reportable Short & Long Positions**  
**(Short-Long, K)**



Source: Haver Analytics & BBVA Research

**Financial Markets**

Graph 15  
**Commodities**  
(Dpb & DpMMBtu)



Source: Bloomberg & BBVA Research

Graph 16  
**Gold & Commodities**  
(US\$ & Index)



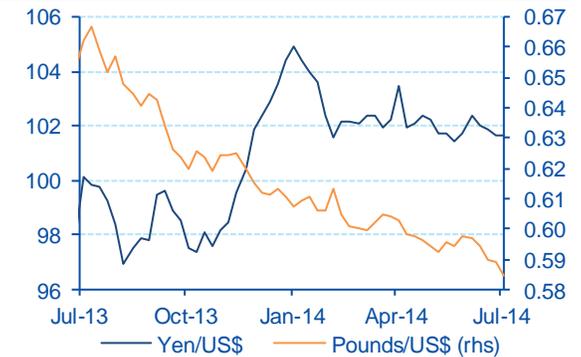
Source: Haver Analytics & BBVA Research

Graph 17  
**Currencies**  
(Dpe & Ypd)



Source: Bloomberg & BBVA Research

Graph 18  
**6-Month Forward Exchange Rates**  
(Yen & Pound / US\$)



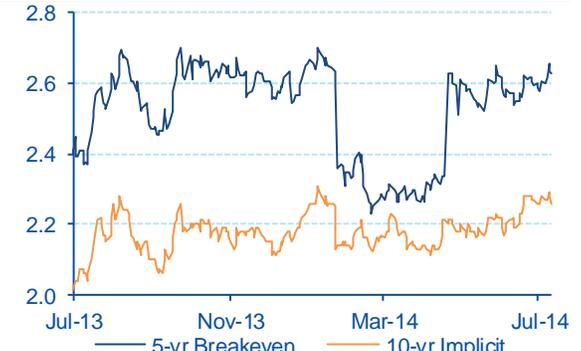
Source: Haver Analytics & BBVA Research

Graph 19  
**Fed Futures & Yield Curve Slope**  
(% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 20  
**Inflation Expectations**  
(%)



Source: Bloomberg & BBVA Research

## Interest Rates

Table 1  
**Key Interest Rates (%)**

	Last	Week ago	4-Weeks ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	14.86	14.86	14.82	14.10
New Auto (36-months)	2.90	2.90	2.85	2.45
Heloc Loan 30K	5.00	5.01	5.06	5.29
5/1 ARM *	2.99	2.98	3.05	2.90
15-year Fixed Mortgage *	3.24	3.22	3.31	3.23
30-year Fixed Mortgage *	4.15	4.12	4.20	3.99
Money Market	0.40	0.40	0.37	0.44
2-year CD	0.82	0.82	0.82	0.73

\*Freddie Mac National Mortgage Homeowner Commitment US  
Source: Bloomberg & BBVA Research

Table 2  
**Key Interest Rates (%)**

	Last	Week ago	4-Weeks ago	Year ago
1M Fed	0.09	0.10	0.10	0.09
3M Libor	0.23	0.23	0.23	0.27
6M Libor	0.33	0.33	0.32	0.40
12M Libor	0.55	0.55	0.55	0.69
2yr Sw ap	0.62	0.65	0.60	0.50
5yr Sw ap	1.74	1.82	1.78	1.56
10Yr Sw ap	2.63	2.74	2.71	2.75
30yr Sw ap	3.30	3.43	3.38	3.57
30day CP	0.11	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.12	0.13	0.13	0.17

Source: Bloomberg & BBVA Research

## Quote of the Week

Stanley Fischer, Federal Reserve Vice Chairman  
Financial Sector Reform: How Far Are We?  
10 July 2014

*"In short, actively breaking up the largest banks would be a very complex task, with uncertain payoff."*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
15-Jul	US Empire State Manufacturing Survey General Business Conditions SA	JUL	15.50	17.00	19.28
15-Jul	Adjusted Retail & Food Services Sales SA Total Monthly % Change	JUN	0.40	0.60	0.30
15-Jul	Adjusted Retail Sales Less Autos and Gas Stations SA MoM Percent Change	JUN	0.20	0.50	0.00
15-Jul	US Import Price Index by End Use All MoM NSA	JUN	0.30	0.40	0.10
15-Jul	US Manufacturing & Trade Inventories Total MoM SA	MAY	0.40	0.60	0.60
16-Jul	US PPI Final Demand MoM SA	JUN	0.20	0.20	-0.20
16-Jul	US PPI Final Demand Less Foods and Energy MoM SA	JUN	0.20	0.20	-0.10
16-Jul	US Industrial Production MoM 2007=100 SA	JUN	0.40	0.30	0.60
16-Jul	US Capacity Utilization % of Total Capacity SA	JUN	79.20	79.30	79.10
16-Jul	US Industrial Production Industry Groups Manufacturing MoM SA	JUN	0.50	0.30	0.60
16-Jul	National Association of Home Builders Market Index SA	JUL	50.00	50.00	49.00
17-Jul	US Initial Jobless Claims SA	JUL 12	305.00	310.00	304.00
17-Jul	US Continuing Jobless Claims SA	JUL 5	2550.00	2580.00	2584.00
17-Jul	US New Privately Owned Housing Units Started by Structure Total SAAR	JUN	1020.00	1025.00	1001.00
17-Jul	Private Housing Authorized by Bldg Permits by Type Total SAAR	JUN	1035.00	1036.50	1005.00
17-Jul	Philadelphia Fed Business Outlook Survey Diffusion Index General Conditions	JUL	14.70	16.00	17.80
18-Jul	University of Michigan Survey of Consumer Confidence Sentiment	JUL P	83.10	83.00	82.50
18-Jul	Conference Board US Leading Index MoM	JUN	0.50	0.50	0.50

**Forecasts** (NOTE: revisions pending)

	2011	2012	2013	2014	2015	2016	2017
Real GDP (% SAAR)	1.8	2.8	1.9	2.5	2.5	2.8	2.8
CPI (YoY %)	3.1	2.1	1.5	1.8	2.2	2.3	2.4
CPI Core (YoY %)	1.7	2.1	1.8	1.9	2.1	2.3	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.6	5.9	5.6	5.2
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50	2.50
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	3.00	3.50	3.75	4.00
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.31	1.29	1.36	1.36

**DISCLAIMER**

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research U.S. on behalf of itself and its affiliated companies (each BBVA Group Company) for distribution in the United States and the rest of the world and is provided for information purposes only. Within the US, BBVA operates primarily through its subsidiary Compass Bank. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document have been gathered or obtained from public sources, believed to be correct by the Company concerning their accuracy, completeness, and/or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.