Central Banks

FOMC Statement: September 16th – 17th

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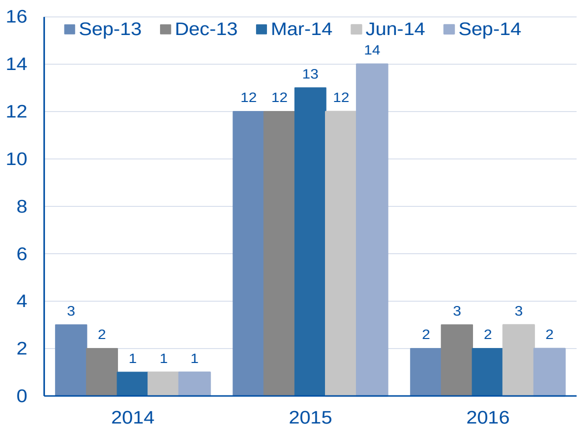
Timing of Policy Tightening Unchanged

- **QE3 purchases reduced to $15bn, planning to end the program at the next meeting**
- **Forward guidance remained unchanged communicating no shifts in FOMC stance on the timing of the first federal funds rate increase**
- **2 members voted against the FOMC action on concerns of too dovish communication by the Committee**
- **2015 kept as most likely year for the FOMC to start monetary policy firming while pace of policy firming indicated slightly steeper path**
- **FOMC released “Policy Normalization Principles and Plans”**

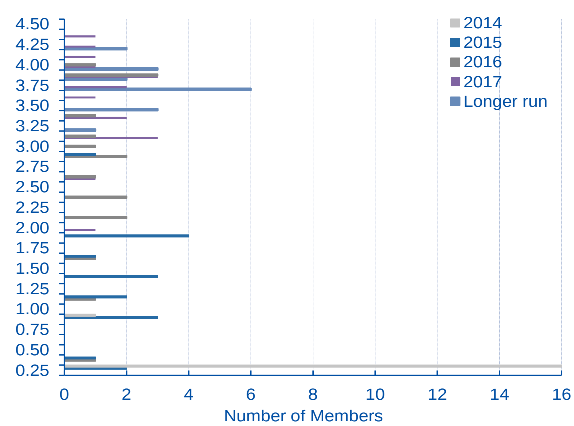
The September FOMC meeting reduced the pace of large scale asset purchases by another $10bn. The October asset purchases would consist of $5bn mortgage-backed securities (MBS) and $10bn longer-term Treasury securities. The Committee also committed to end the purchases program “at its next meeting.” The FOMC statement and communication remained dovish. Language regarding “significant underutilization of labor resources” remained unchanged. There were also no changes to forward guidance, confirming that there will be a “considerable time” lapse between the end of the QE3 and the first rate hike. Fisher (FRB Dallas) and Plosser (FRB Philadelphia) were the 2 dissents to the FOMC statement. Both FRB presidents objected to the current stance of forward guidance regarding the “considerable time” statement, which according to them overstates the amount of time the Fed would be able to wait before the first federal fund rate hike.

Chart 1
Appropriate Timing of Policy Firming (Number of participants)



Source: Federal Reserve & BBVA Research

Chart 2
Target Federal Funds Rate Forecast (Year-end %)



Source: Federal Reserve & BBVA Research

The FOMC's projections of appropriate monetary policy indicated an additional member switching from 2016 to 2015 for the appropriate timing of policy firming. 14 of 17 members retained 2015 as the most likely year for FOMC policy firming. Contrary to the dovish Fed communication, the Committee's projections on the appropriate path of the federal funds rate indicated slightly steeper trajectory in 2016 and 2017. This is the first look at what FOMC members projected for 2017 and showed convergence to a more centrist position of dovish FOMC members. Accordingly, the mean of Committee's projected midpoint of target range for the federal funds rate is between 1.25% and 1.50% by the end of 2015, between 2.75% and 3.0% by the end of 2016, and around 3.5 by the end of 2017.

The economic outlook continues to play the central role in the Fed's decisions on policy normalization. Once again, the Summary of Economic Projections slightly downgraded real GDP growth and lowered the unemployment rate. The inflation rate, as before, is expected to converge slowly to the FOMC 2% long-run objective.

In addition to confirmed end to QE3, the FOMC released a separate document outlining tools at its disposal for policy normalization and a general sense of the degree each tool would be used. As outlined in the previous minutes (Fed Watch August 20th), the Fed will communicate a target and a probable range for the Fed Funds Rate. The primary tool for guiding rates will be interest paid on excess reserves (IOER), which will be supplemented by overnight reverse repurchase agreements (ON RPP). Chair Yellen, in her post-statement interview, did confirm that some degree of tolerance will be given to rates slightly above or below probable range.

The policy normalization addendum also mentioned a tapering like approach to principal reinvestment of securities that would be data-dependent and gradual. However, with respect to MBS principal reinvestment, the committee "does not anticipate selling agency mortgage-backed securities as part of the normalization process" and that the "timing and pace of any sales would be communicated to the public in advance."

Table 1
Federal Reserve Forecast Comparison: September vs. June FOMC Statement and Press Conference (Central Tendency)

	September 2014 FOMC Projections					June 2014 FOMC Projections			
	2014	2015	2016	2017	Longer run	2014	2015	2016	Longer run
GDP, 4Q yoy % change									
Low	2.0	2.6	2.6	2.3	2.0	2.1	3.0	2.5	2.1
High	2.2	3.0	2.9	2.5	2.3	2.3	3.2	3.0	2.3
Unemployment rate, 4Q %									
Low	5.9	5.4	5.1	4.9	5.2	6.0	5.4	5.1	5.2
High	6.0	5.6	5.4	5.3	5.5	6.1	5.7	5.5	5.5
Core PCE, 4Q yoy % change									
Low	1.5	1.6	1.8	1.9		1.5	1.6	1.7	
High	1.6	1.9	2.0	2.0		1.6	2.0	2.0	

Source: Federal Reserve & BBVA Research

Bottom Line: Labor Market Underutilization Remains a Concern

In spite of recent uptick in inflation and consistent employment, Chair Yellen's press conference confirmed that labor market underutilization remains a concern and inflation is well-anchored, which keeps our forecast for the first rate hike unchanged at mid-2015. In addition, FOMC projections for pace of policy firming suggests convergence amongst hawkish and dovish views to a more centrist position, which also implies rate increases in mid-2015 and lower rates in the long-run. Despite agreement over the tools to be used for policy normalization and less dispersion regarding policy firming, members still disagree how to perceive the "economic outlook" and what qualifies as improvement sufficient enough to "warrant a less accommodative monetary policy." Thus, policy actions will remain data-dependent.