Central Banks

FOMC Minutes: September 16th – 17th

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Committee Acknowledges Communication Challenges Laying Ahead

- **FOMC delayed changes to forward guidance "to err on the side of patience"**
- **Committee acknowledged future communication challenges when changes become appropriate**
- **Divergent views regarding the remaining slack in labor market and the speed of inflation convergence with the target**
- **All but one member supported the released "Policy Normalization Principles and Plans"**

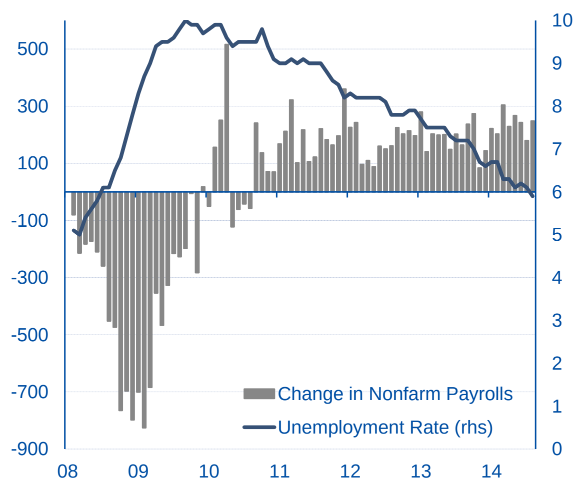
The September minutes offered a glimpse inside the FOMC decision to keep what was interpreted by markets as a "dovish" stance on unchanged forward guidance. Why did the FOMC retain the language regarding the "considerable time" between the end of QE3 and the first rate hike? According to the minutes, some participants saw it as a "risk-management" tool, suggesting that "it would be prudent to err on the side of patience while awaiting further evidence of sustained progress toward the Committee's goals." There was also cautiousness against a change in forward guidance that could be misinterpreted as a "signal of a fundamental shift" in FOMC policy stance. However, the Committee's worry regarding the risks of downside economic shocks was not domestic in nature but rather could arise abroad due to the global economic slowdown and the appreciation of the dollar, particularly against the euro, the yen and the pound sterling. However, several participants thought that the current forward guidance conveys a longer period before the first policy rate liftoff and suggests a more gradual increase in the federal funds rate than "they believed was likely to be appropriate given economic and financial conditions."

Further discussions on forward guidance highlighted the eventual need of evolution in the language used as the future change in the policy stance will also require a new manner to convey it. While approaches to what would be an appropriate change to forward guidance varied, the FOMC agreed that "when changes to the forward guidance become appropriate, they will likely present communication challenges, and that caution will be needed to avoid sending unintended signals about the Committee's policy outlook." So far, the FOMC has highlighted that on balance, the geopolitical conflicts, such as events in the Middle East and Ukraine, have limited the effect of what could be perceived as a "hawkish" communication on the longer end of the yield curve.

While the FOMC believes that the current formulation of the forward guidance communicates the Fed commitment to data driven policy changes, the views regarding both the labor market conditions and the pace of inflation within the Committee diverge. FOMC views differed regarding the speed of labor market recovery and the extent of remaining slack, with particular attention drawn to the low levels of labor participation rate and the lack of a broad-based increase in wage inflation. Nevertheless, most agreed that underutilization of labor resources remained significant, which likely led the Committee to keep unchanged the language from the September statement regarding "significant underutilization of labor resources." Likewise the individual views within the Committee diverged on the assessment of the speed with which the inflation would reach the 2% FOMC target. While most recognized that the risk that inflation would run persistently below the target level diminished, a couple of participants acknowledged that longer-term inflation expectations could be slightly lower than the 2% objective.

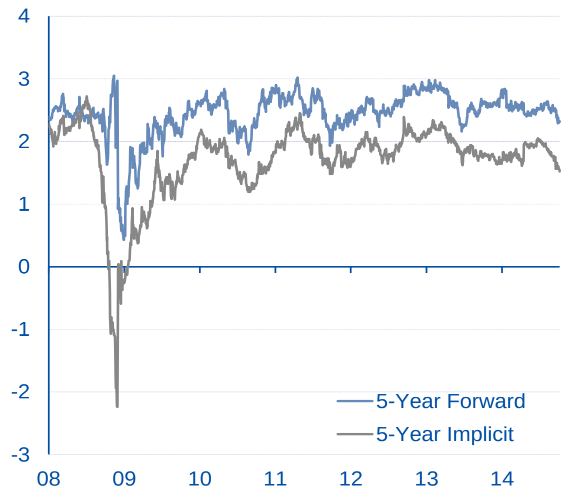
Together with the statement, the FOMC also released "Policy Normalization Principles and Plans" which was supported by all but Lacker (FRB Richmond). Lacker released his formal comments on the normalization plan where he stated: "I did not support the full statement. Specifically, I did not support plans for the assets on the Fed's balance sheet" (September 19th).

Chart 1
Unemployment Rate and Nonfarm Payrolls (% and MoM Change in K)



Source: BLS & BBVA Research

Chart 2
Inflation Expectations (%)



Source: FRB & BBVA Research

Bottom Line

Despite the positive economic data, the FOMC's delay in introducing changes to the forward guidance language coupled with "most" participants agreement that "underutilization of labor resources remained significant" conveyed an overall "dovish" stance, and reinforced Fed's dovish September's statement. The minutes communication also reverted the "hawkish" message of July's meeting minutes where many participants were concerned of medium-term over overshooting of economic objectives. Thus, the Committee has likely aimed to push back market expectations regarding the timing of the first policy rate hike aligning it with recent Fed speak of "middle of next year" (Dudley, FRB New York, October 7th). This reassures our expectation of the first federal funds rate increase occurring in mid-2015. Likewise, we expect that the Fed will continue to adjust policy plans and the overall trajectory of federal fund rate dependent on incoming data.