Central Banks

FOMC Minutes: October 28th – 29th Meeting

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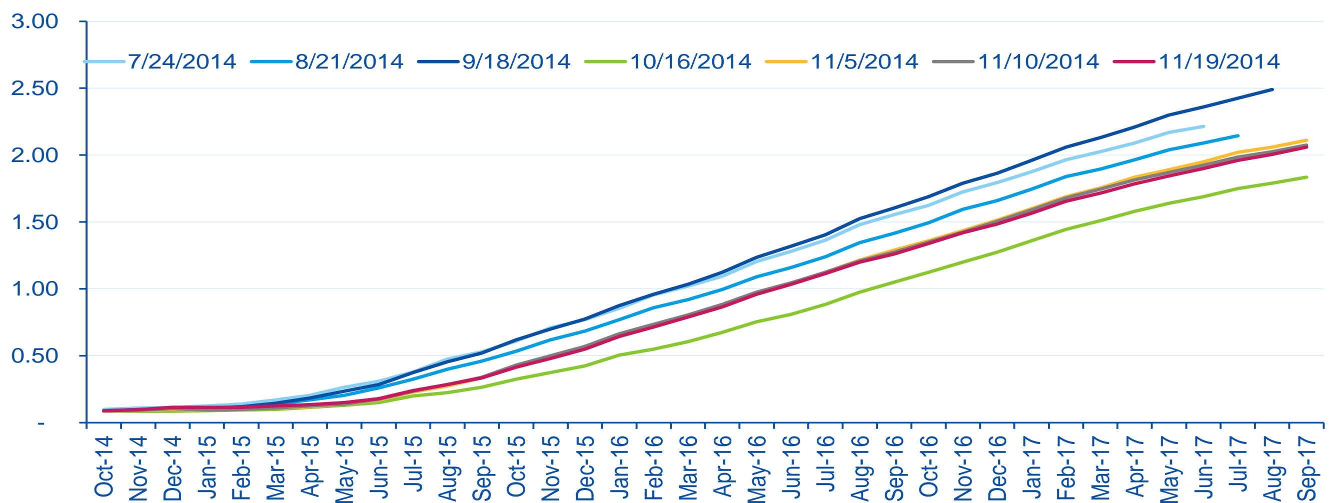
Committee Stresses Importance of Data-Dependent Policy

- **FOMC ends QE3 in majority agreement that program goals have been achieved**
- **Increased focus on financial and global economic conditions, with the USD appreciation and slower global growth forcing a downward revision to mid-term GDP**
- **Discussion over "considerable time" language hints at FOMC's caution toward potential changes in future meeting statements**

The minutes from October's FOMC meeting revealed some further discussion on forward guidance and post-QE3 strategies, but nothing stood out as a major surprise. There was very little debate on actually ending the asset purchase program, as most participants had already come around to the idea of announcing the end of QE3 at this meeting. Committee members agreed that the program had achieved its goals outlined back in September 2012 and that there was "sufficient underlying strength in the broader economy to support ongoing progress toward maximum employment in a context of price stability." Moreover, participants expect that, "over the medium term, real economic activity would increase at a pace sufficient to lead to a further gradual decline in the unemployment rate toward levels consistent with the Committee's objective of maximum employment." However, a number of participants noted that "underutilization of labor market resources remained" while a couple indicated that "the unemployment rate was understating the degree of labor market underutilization." Still, the improvement in the employment situation was deemed to be consistent with the goals outlined at the start of QE3 and was therefore a suitable argument for finally ending the asset purchase program in October.

Chart 1
Federal Funds Rate Futures (%)



Source: Bloomberg & BBVA Research

As usual, the FOMC minutes analyzed the latest happenings in the economy, this time with a heavier focus on foreign economic and financial conditions compared to prior meetings. The Committee agreed that economic activity between meetings had been "close to expectations", but a few factors warranted a slight downward revision to GDP projections in the mid-term: appreciation of the U.S. dollar, discouraging global growth expectations, and a drop in equity prices. Risks to growth were seen as more biased to the downside, and FOMC members agreed that "neither monetary policy nor fiscal policy appeared well positioned to help the economy withstand adverse shocks."

Given the importance of financial market trends, FOMC members examined the pros and cons of including language in the statement that would make reference to such developments. Although this commentary would improve the Committee's transparency when it comes to their emphasis on data-dependency, members ultimately decided against it with the risk that the FOMC might appear more reactionary to market volatility. Members also discussed the idea of adding language on the global economy but in the end agreed that it would suggest a more pessimistic outlook than they were willing to portray.

Some participants were concerned about the recent decline in market-based inflation expectations, pointing out that it could reflect lower inflation risk premium. However, most members agreed that this matter required attention in case longer-term inflation expectations edge down, particularly if growth falters.

Leading up to the October meeting, there was talk that the FOMC would remove the "considerable time" language from their forward guidance communication. While the statement ultimately left the wording unchanged, the meeting minutes did hint at more divergent views within the Committee. All participants were in agreement that the timing of the first rate hike would remain data-dependent, yet some felt that the "considerable time" piece contradicted plans to increase rates based on incoming economic data. Others argued that removing "considerable time" from the forward guidance language would signal a "significant shift" in the FOMC's policy stance and have unwanted financial market reaction or hint at an earlier hike than would seem appropriate by the Committee. This debate suggests that a change to the Committee's forward guidance is likely once they reach some level of consensus on the new wording, which in turn is tied to how much market expectations may or may not diverge from the FOMC's outlook.

The FOMC meeting discussion also touched on the "post-liftoff policy" and the Committee's plans regarding the pace of interest rate hikes. Many members suggested that it would be helpful to begin incorporating language related to their strategy, but the group concluded that this would "pose challenges given the inherent uncertainty of the economic and financial outlook and the Committee's desire to retain flexibility to adjust policy in response to the incoming data."

Finally, on broader communications topics, the FOMC is considering constructing a consensus forecast and further enhancements to the Summary of Economic Projections. These issues will be discussed during upcoming meetings and thus, we don't expect any imminent changes.

Bottom Line

The end to QE3 has come and gone without a hitch, and now the FOMC is preparing to move on to the next stage. Discussion on the first fed funds rate hike has certainly intensified, yet it is clear that the actual liftoff is not going to be immediate. The fact that the FOMC has re-emphasized their data-dependent strategy confirms our expectations for a mid-2015 rate hike, assuming that economic activity continues to improve at a gradual pace. We cannot rule out an early rate hike, but it doesn't seem that the Committee is quite ready to deal with and communicate the post-liftoff plans, particularly given increased downside risks to growth. As such, we expect to see additional discussion in future meetings regarding the expected pace of interest rate hikes, of course with data-dependency as a key focus.

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