

Economic Analysis

FOMC Meeting Minutes: Fed's Boundaries of "Patient" Expand with Uncertainty on Inflation

Kim Fraser Chase

The central piece of the FOMC January meeting minutes, the policy planning discussion, revealed participants' debate regarding the earlier vs. later date of policy firming. The discussion had many participants "inclined toward keeping the federal funds rate at its effective lower bound for a longer time." Only some participants were concerned that the policy rate may "have already been kept at its lower bound for a sufficient length of time, and that it might be appropriate to begin policy firming in the near term." The uncertainty regarding the inflation outlook continued to take center stage in the FOMC discussion. Committee members' opinions differed on how transitory the current downward pressure on inflation could be, as well as on the causes of low inflation expectation readings. Likewise, members diverged in their measurements on labor underutilization. While some participants, likely dovish, lowered their estimates of the longer-run normal rate of unemployment due to continued softness in inflation, few others anticipated a quicker end to labor force underutilization. With regard to the substantial decline in nominal longer-term interest rates, the FOMC discussed the possible shifts of funds from abroad that put downward pressure on the term premium, while also noting that foreign investment flows likely resulted in the decline of TIPS-based measures of inflation compensation. Overall, the minutes highlight that the precise date of the policy rate liftoff will bear less importance on economic outcomes under the assumption that the Committee will implement an effective strategy to communicate the data-dependent path for the federal funds rate. The implementation of clear communication in a manner that will "underscore" the data dependency of the monetary policy decisions, such as setting expectations for investors and policymakers that unanticipated economic developments can warrant a federal funds path that is different from the one currently expected, presented its own challenges. The FOMC remained concerned with downward pressures on prices and the risk that the low inflationary environment will be more long-lasting than currently expected. We maintain our baseline scenario for a liftoff in mid-2015 (see our latest [FedWatch](#)).

Utilities & Manufacturing Lead Modest Industrial Production Growth in January

Industrial production increased 0.2% in January following a downwardly revised 0.3% decline in December. January's report marked a positive rebound for the manufacturing and utilities components, up 0.2% and 2.3%, respectively. Mining output declined for the third time in four months, down 1.0% to start the year. Extreme winter weather conditions have likely played a role in the latest volatility in economic data, and we expect to see a similar influence in February as well. Manufacturing activity remains subdued but should see a boost later in the year due to the lagged impact from falling oil prices and cheaper input costs. On a YoY basis, manufacturing output accelerated significantly to 5.5% in January from 4.4% in December. Despite this month-to-month volatility, annual growth for total industrial production remains steady near 4.5%. Once we get past the usual seasonal issues that the winter brings, we expect to see stronger monthly reports for industrial production.

Week Ahead

Existing Home Sales (January, Monday 10:00 ET)

Forecast: 5010K

Consensus: 5000K

Previous: 5040K

Existing home sales are expected to decline slightly in January following a relatively healthy increase in December. Housing activity tends to get a bit tricky during the winter months, when seasonal factors play a bigger role. January's sales were likely impacted by severe winter weather conditions across the country, although the seasonal adjustments to the data may help to offset this influence. Pending home sales, which tend to be a leading indicator for the existing home market, declined significantly in December and point to a weak start to 2015 for existing home sales.

Consumer Confidence (February, Tuesday 10:00 ET)

Forecast: 97.5

Consensus: 99.8

Previous: 102.9

Consumer confidence jumped significantly in January to a recovery high, quickly approaching the pre-crisis peak. However, we have already seen a modest adjustment in February, with the consumer sentiment index falling back slightly from January's big gain. While the two reports do not always move hand in hand, it is likely that we will see a similar correction from the previous month. Consumer expectations remain on an upward trend, even though they are relatively volatile from month to month. Views on the present situation will likely tick back given the latest stabilization in oil prices near \$50dbp that may be cutting into positive consumer attitudes.

Consumer Price Index, Core (January, Thursday 8:30 ET)

Forecast: -0.3%, 0.1%

Consensus: -0.6%, 0.1%

Previous: -0.4%, 0.0%

Headline CPI is expected to decline in January for the third consecutive month as falling oil prices continue to weigh on the index. Crude oil prices dropped nearly 20% from December to January at a similar pace as in the previous month. Natural gas prices fell more than 12% while other commodities continued on a downward trend. Import and producer prices also declined in January, pointing to another decline for consumer prices as well. Core inflation was unchanged in December but is expected to tick upward slightly in January as services prices offset the declining commodity components.

Real GDP, Preliminary (4Q14, Friday 8:30 ET)

Forecast: 2.4%

Consensus: 2.1%

Previous: 2.6%

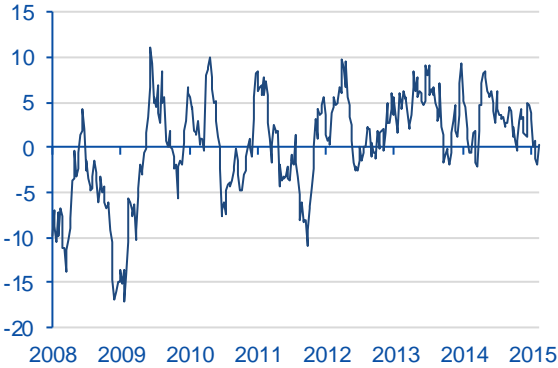
Real GDP growth for 4Q14 is expected to be revised down slightly with the second estimate. News since the initial report suggest that actual data was worse than the assumptions used in the first calculation. Real personal consumption expenditures declined in December, while business inventories grew at a much slower pace than expected. December's trade balance deteriorated, with real exports weak for the second consecutive month but real imports on the rise. Construction spending increased modestly to close out 2014 but is not a big enough component of GDP growth to offset the disappointing data from other sectors.

Market Impact

Markets will have a lot to digest on the economic calendar this week, with inflation topping the list of the highly anticipated indicators. Although we expect another CPI decline, we have already seen a very slight recovery in oil prices for February thus far, so it's possible that markets won't read too much into January's report (at least as it relates to the Fed's future plans). The second estimate for GDP may move markets if the revision is significant, but overall the figure shouldn't have much impact.

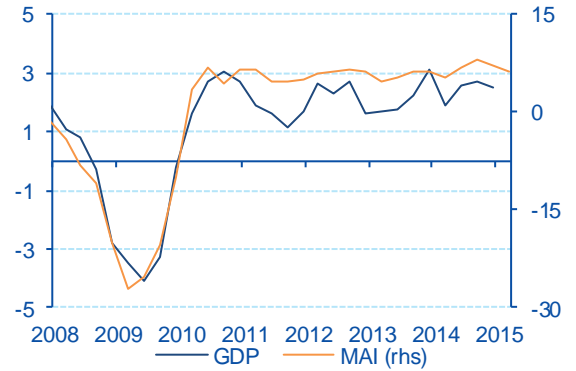
Economic Trends

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



Source: BBVA Research

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



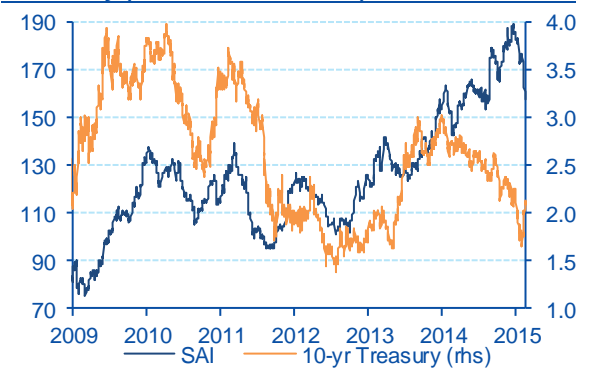
Source: BBVA Research & BEA

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



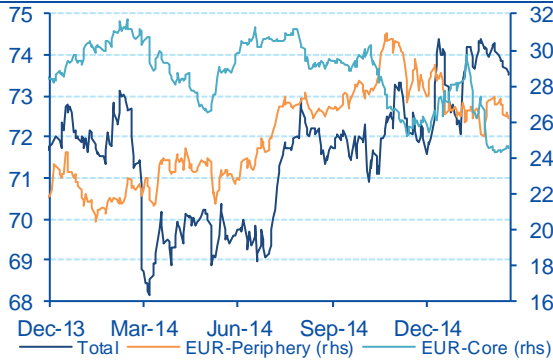
Source: BBVA Research

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



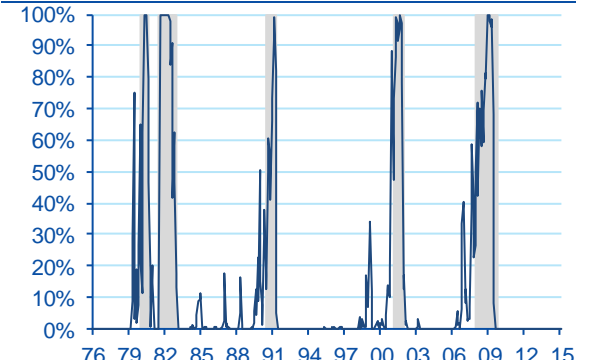
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

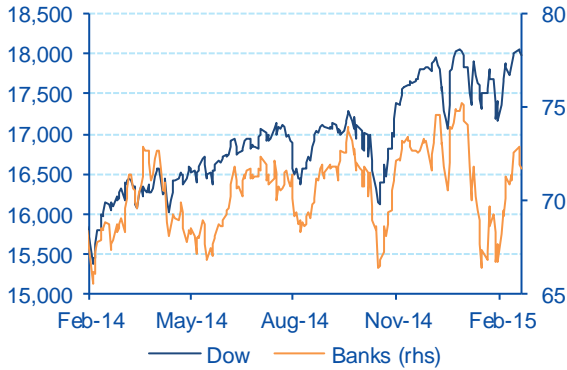
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

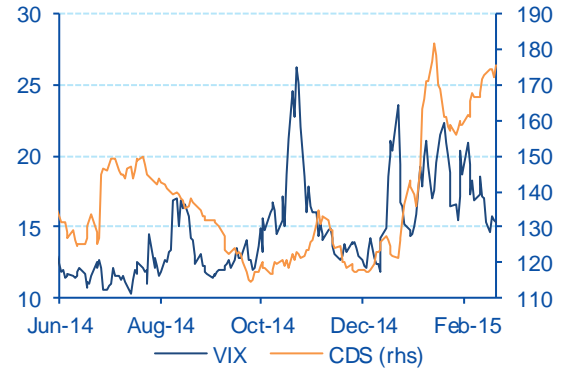
Financial Markets

Graph 9
Stocks
(Index, KBW)



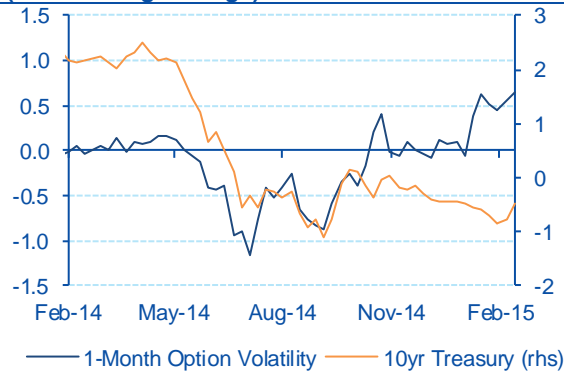
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



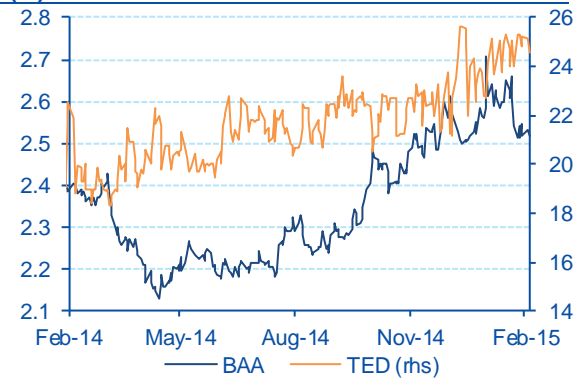
Source: Bloomberg & BBVA Research

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



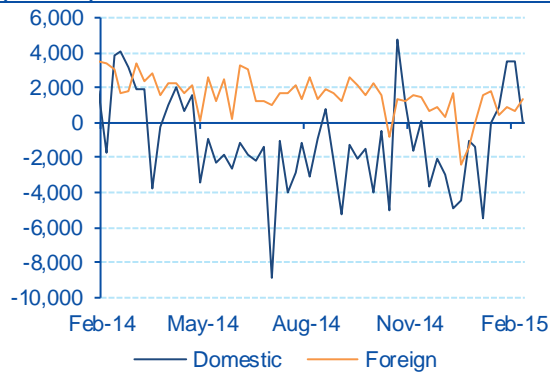
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



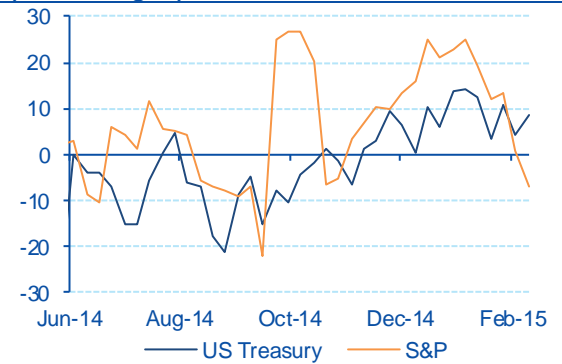
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

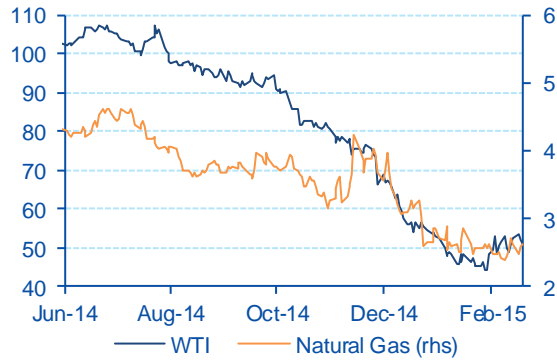
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

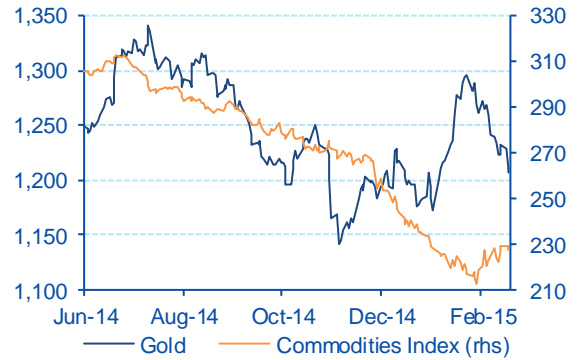
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



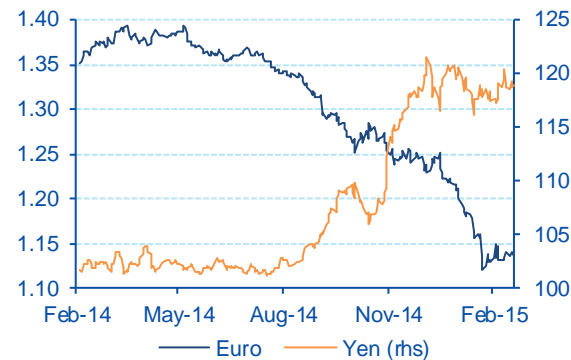
Source: Bloomberg & BBVA Research

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



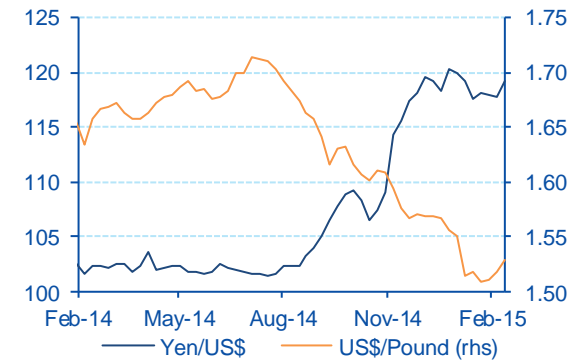
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



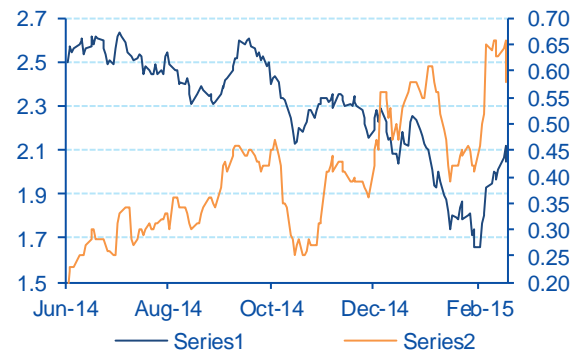
Source: Bloomberg & BBVA Research

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



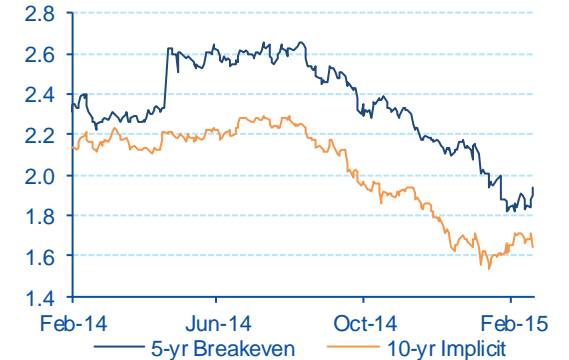
Source: Haver Analytics & BBVA Research

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)	14.96	14.96	14.86	14.10
New Auto (36-months)	2.67	2.68	2.64	2.39
Heloc Loan 30K	4.93	4.92	4.99	5.35
5/1 ARM *	2.97	2.97	2.83	2.90
15-year Fixed Mortgage *	3.05	2.99	2.93	3.23
30-year Fixed Mortgage *	3.76	3.69	3.63	3.99
Money Market	0.42	0.42	0.42	0.41
2-year CD	0.84	0.84	0.83	0.80

*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	0.12	0.12	0.12	0.07
3M Libor	0.26	0.26	0.23	0.23
6M Libor	0.39	0.38	0.32	0.33
12M Libor	0.68	0.66	0.55	0.55
2yr Sw ap	0.90	0.89	0.77	0.46
5yr Sw ap	1.73	1.65	1.52	1.65
10Yr Sw ap	2.24	2.12	2.00	2.83
30yr Sw ap	2.64	2.48	2.36	3.66
30day CP	0.12	0.12	0.11	0.12
60day CP	0.13	0.11	0.11	0.15
90day CP	0.15	0.13	0.13	0.12

Source: Bloomberg & BBVA Research

Quote of the Week

Jerome Powell, Federal Reserve Bank Governor
Fed Aims Not to Surprise Markets When it Drops 'Patient'
18 February 2015

"Our agenda is not to surprise markets. It is to be as clear and transparent as possible, to keep our framework out there, and let markets understand where we're going."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
23-Feb	Chicago Fed National Activity Index	JAN	0.30	0.05	-0.05
23-Feb	US Existing Homes Sales SAAR	JAN	5.01	5.00	5.04
23-Feb	US Existing Homes Sales MoM SA	JAN	-0.60	-0.79	2.44
23-Feb	Dallas Fed Manufacturing Outlook Level Of General Business Activity	FEB	0.50	0.00	-4.40
24-Feb	S&P/Case-Shiller Composite-20 City Home Price Index SA MOM % Change	DEC	0.50	0.60	0.74
24-Feb	S&P/Case-Shiller Composite-20 City Home Price Index YoY	DEC	4.09	4.40	4.31
24-Feb	Conference Board Consumer Confidence SA 1985=100	FEB	97.50	99.75	102.90
25-Feb	US New One Family Houses Sold Annual Total SAAR	JAN	460.00	475.00	481.00
25-Feb	US New One Family Houses Sold Annual Total MoM SA	JAN	-4.37	-1.25	11.60
26-Feb	US Initial Jobless Claims SA	21-Feb	285.00	290.00	283.00
26-Feb	US Continuing Jobless Claims SA	14-Feb	2400.00	2360.00	2425.00
26-Feb	US Durable Goods New Orders Industries MoM SA	JAN	0.70	1.55	-3.30
26-Feb	US Durable Goods New Orders Total ex Transportation MoM SA	JAN	0.30	0.50	-0.80
26-Feb	US CPI Urban Consumers MoM SA	JAN	-0.30	-0.60	-0.37
26-Feb	US CPI Urban Consumers Less Food & Energy MoM SA	JAN	0.10	0.10	0.00
27-Feb	GDP US Chained 2009 Dollars QoQ SAAR	4Q S	2.40	2.10	2.60
27-Feb	GDP US Personal Consumption Chained 2009 Dirs % Change from Previous Period SAAR	4Q S	4.30	4.30	4.30
27-Feb	US GDP Price Index QoQ SAAR	4Q S	0.00	0.00	0.00
27-Feb	US GDP Personal Consumption Core Price Index QoQ % SAAR	4Q S	1.00	1.10	1.10
27-Feb	MNI Chicago Business Barometer (sa)	FEB	59.00	58.50	59.40
27-Feb	University of Michigan Consumer Sentiment Index	FEB F	94.00	94.00	93.60
27-Feb	US Pending Home Sales Index MoM SA	JAN	0.50	2.35	-3.73

Forecasts

	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% SAAR)	1.8	2.8	1.9	2.4	2.9	2.8	2.8	2.9
CPI (YoY %)	3.1	2.1	1.5	1.6	1.5	2.1	2.2	2.3
CPI Core (YoY %)	1.7	2.1	1.8	1.8	1.9	2.1	2.2	2.3
Unemployment Rate (%)	8.9	8.1	7.4	6.1	5.3	4.9	4.6	4.5
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50	2.50	3.25
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	2.21	2.60	3.11	3.54	3.90
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	1.15	1.20	1.28	1.32

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