Central Banks

FOMC Statement: April 28th – 29th

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FOMC Review of Economic Activity Hints at Rate Hike After June

- **Committee acknowledged the 1Q15 slowdown based on jobs, spending, and exports**
- **Increased concerns over import price declines and the potential impact on core inflation**
- **We maintain our expectations for the first rate hike in September, closing out 2015 at 0.5%**

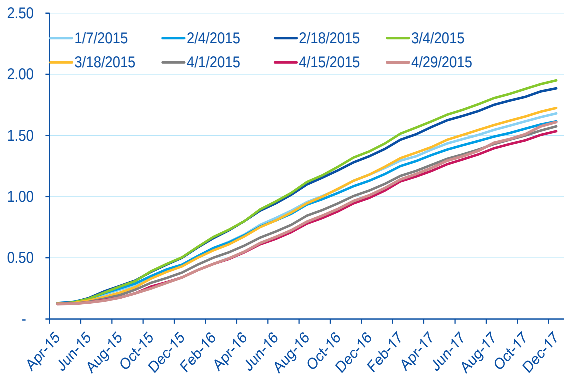
April's FOMC announcement was quite underwhelming compared to the previous few months, though there were hidden signs to suggest possible delays to the rate hike. As expected, the Committee did not announce a rate hike at this time but maintained the usual forward guidance language regarding their data dependent strategy. Furthermore, the statement did not take any big risks in signaling that the first rate hike is any closer than it was during last month's meeting. There was no specific mention that a rate hike remains "unlikely" in June, yet the overview of recent economic activity had more negative undertones that would not be consistent with increasing the federal funds rate at the next FOMC meeting.

The Committee acknowledged that activity throughout the first quarter had "slowed" rather than just "moderated somewhat" and was only "in part reflecting transitory factors." This reveals a more realistic perspective from the Fed on the lack of strength in recent economic activity and goes hand-in-hand with the details of the BEA's advance release for 1Q15 GDP growth (see our brief). Also, the revised language confirms the downward revisions to GDP projections that were released at the March FOMC meeting. The April statement alluded to what we have already seen in recent economic reports: slower job growth, weak household spending, "softened" business investment, and declining exports. The fact that the FOMC perceived underutilization of labor market resources as "little changed" puts additional focus on the upcoming employment report for April. A recovery in labor market indicators will quickly put them back on track with their labor market projections.

Views on inflation were adjusted somewhat to reflect that prices were no longer declining further but rather "continued to run below" the Fed's target. The statement also clarified that low inflation was only "partly" due to declines in energy prices (not "largely" as was the case in March), adding in "decreasing prices of non-energy imports" as further reasoning. The addition of import prices reflects the Committee's increased concerns over the USD appreciation and suggests that they may expect downward pressure on core inflation in the coming months. This opens the door for more uncertainty in the future as the Committee remains on edge, taking upcoming economic data day by day.

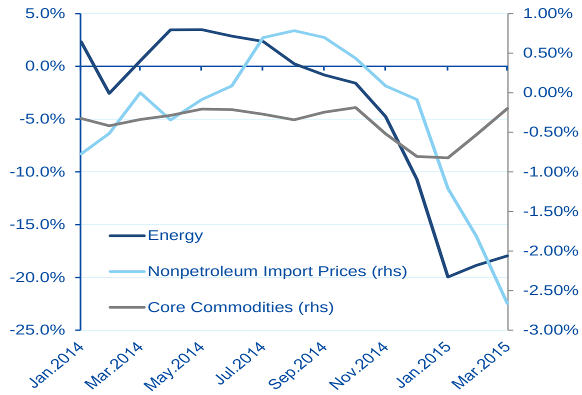
Despite the weak first quarter, the FOMC's expectations for future economic activity have not changed. They are still looking for signs that would suggest a "reasonably confident" outlook that inflation is moving back towards their target in the mid run, along with indications of further improvement in the labor market. At this point, the probability of a June rate hike is close to zero, yet it seems that FOMC members are willing to brush off the weak first quarter as long as data improve in the coming months. Therefore, we continue to expect the first rate hike in September, with a gradual pace of increases thereafter until the economy proves more sustainable.

Chart 1
Federal Funds Rate Probabilities (%)



Source: Bloomberg & BBVA Research

Chart 2
Energy and Non-Energy Prices (YoY % Change)



Source: BLS & BBVA Research

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