Central Banks

FOMC Minutes: April 28th – 29th Meeting

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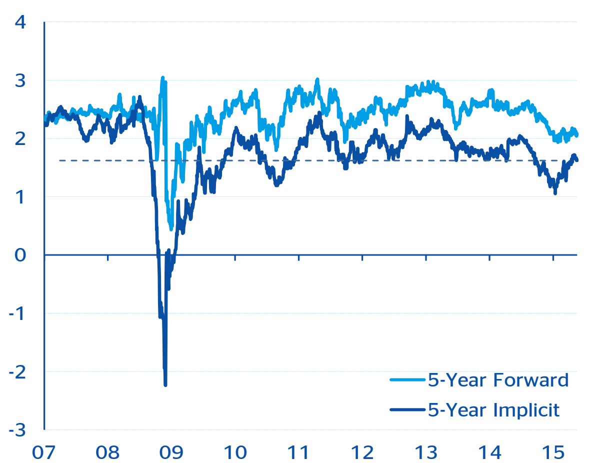
Fed Commits to Clear Communication on the Timing of Liftoff

- **We maintain our expectations for the first rate hike in September as minutes further reduce the likelihood of a June liftoff**
- **Fed communication to remain clear with regard to their assessment of economic outlook and underscores the data dependency of normalization timing**

The FOMC minutes highlighted the Committee's readiness to act on policy normalization but shifted the date of liftoff away from June due to soft economic data in the first quarter. In addition, the FOMC also addressed the challenges of clear communication to avoid market volatility at the time of the commencement of normalization as well as the worry of low estimates of equilibrium real interest rates.

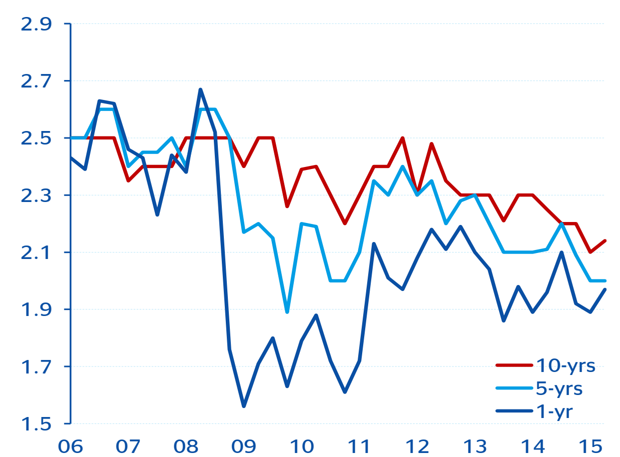
Weak first quarter GDP growth increased the FOMC members' uncertainty around their assessment of the economic outlook and decreased the probability of a June liftoff. Only a "few" participants expected that economic outlook improvement by June will be sufficient for a June liftoff, while "many" remained doubtful that information received by then will be adequate for raising the target range for the policy rate. The Committee's general conclusion was that the weakness in the first quarter growth rate was due to transitory factors and that economic activity will "resume expansion at a moderate pace" in the subsequent quarters. However, overall discussion of the domestic economy carried a pessimistic undertone with an emphasis on whether the experienced economic weakness was transitory or whether it signaled a "longer-lasting loss of momentum."

Chart 1
Market Inflation Expectations (%)



Source: FRB & BBVA Research

Chart 2
Survey Inflation Expectations (%)



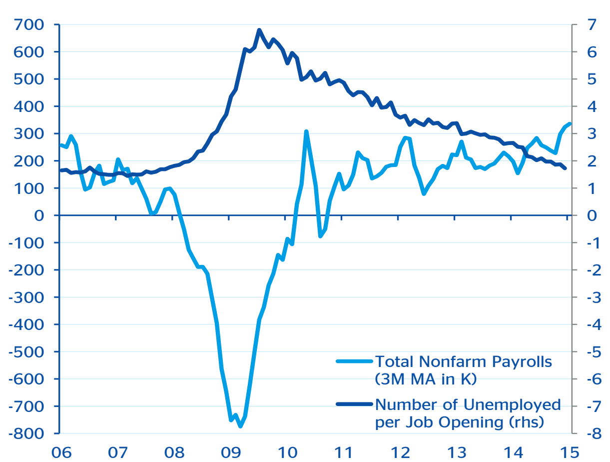
Source: FRB & BBVA Research

The participants found the data on household and investment spending to be disappointing, since the expected positive consumption effect from the decline in oil prices has not yet materialized, while the appreciation of the dollar had a stronger negative impact on economic activity. “Few” FOMC members indicated that they believe that the downside risks to economic growth have risen in comparison to the March outlook. “Most” participants saw the risks to the labor market as balanced, and some judged the latest inflation reading as having firmed. Despite all of this, the Committee did not rule out the possibility of a June rate hike, while the assessment of progress towards that goal will be depend on an improvement in labor market conditions, increased confidence regarding the return of medium term inflation to its 2% target, and information regarding financial and international developments.

Another concern of “some” FOMC members was the fact that estimates of equilibrium real interest rates are “unusually low by historic standards,” which sparked a discussion on the appropriate level of longer-run inflation objectives. Nevertheless, while most agreed on the potential usefulness of such a discussion, the participants found that the reasons behind low equilibrium real interest rate estimates are not defined and are based on factors that can vary from aggregate demand to the low level of term premium.

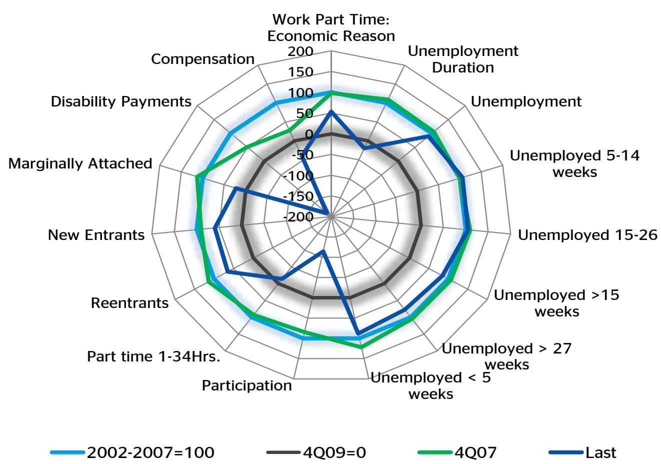
Meanwhile, the key challenge ahead is communication - when and how to communicate to the financial markets the decision to begin policy firming. FOMC members acknowledged that the current low levels of term premiums in the longer-term Treasury market carried risks of another “taper tantrum”-like market reaction, around the time of the commencement of normalization. “Some” participants suggested that “careful” communication will help to decrease market volatility. Participants also discussed the advantages of providing an explicit indication of the policy rate increase consideration within the post-meeting statements released prior to the commencement of policy normalization. Nevertheless, “most” FOMC participants found that communication of intent in the post-meeting releases will contradict the Committee’s data dependent approach. Thus, most participants preferred to determine the appropriate timing of policy firming on a meeting-by-meeting basis.

Chart 3
Nonfarm Payrolls and Unemployed per Job Opening



Source: BLS & BBVA Research

Chart 4
Labor Market Utilization (%)



Source: BLS, DoL, NABE, NFIB, ISM & BBVA Research

Bottom Line: Reinforced Expectations for September Rate Hike

We maintain our baseline scenario for a September liftoff and a gradual pace of federal funds rate increase thereafter. The FOMC remains committed to clear communication and a data dependent approach to determine the appropriate timing of the first rate hike and will act on a meeting-by-meeting basis. Overall, the assessment of economic outlook in the FOMC meetings statements will be one of the main indicators of FOMC readiness to move forward with policy normalization in the near term.