Central Banks

FOMC Minutes: September 16th – 17th Meeting

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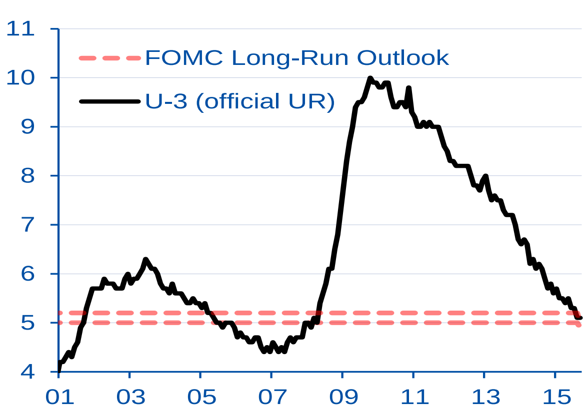
Divided Views in FOMC, Members Moving Farther from Liftoff Consensus

- **FOMC outlook did not change enough to warrant a September rate hike**
- **Most members willing to compromise on falling unemployment rate in order to wait on improvements in inflation and global risks**
- **October is out, and recent data suggest a lower probability for a December liftoff**

September's FOMC meeting did not bring the rate hike that many had expected, and the meeting minutes revealed a wide range of participants' reasoning behind the delay in liftoff. It is becoming clear that Chair Yellen is having a hard time bringing the group to compromise, with too many differing opinions on how economic data have evolved and whether or not the economy is ready for higher interest rates. Siding with the doves appears to be the easier choice for now, and it is likely that the doves will gain even more support given that economic activity throughout the past few weeks have not been convincing enough to suggest significant improvement in the outlook. However, it will be interesting to see what happens when we get to the December meeting, as Yellen has made it clear that she, among others, would like to raise rates by the end of the year.

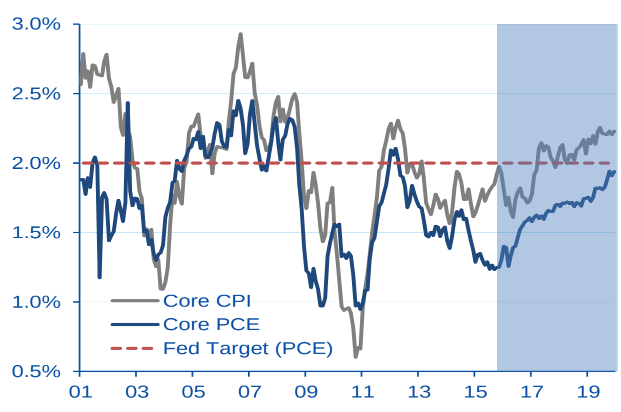
Prior to the September meeting, U.S. economic data seemed to be on a steady road to improvement. Labor market conditions "improved considerably" and underutilization was on the decline. There was no mention of August's sub-200K payroll playing a role in the Fed's decision to postpone the first rate hike. However, some members argued that "further progress was possible," once again citing the falling participation rate and elevated part-time employment for economic reasons. The fact that the unemployment rate has reached their long-run projection encouraged many FOMC members but also made them realize that "eliminating slack along such broader dimensions might require a temporary decline in the unemployment rate below its longer-run normal level." In their view, this will also encourage stronger wage growth than what we have seen in the past few years.

Chart 1
Unemployment Rate and FOMC Outlook (%)



Source: BLS, FRB, & BBVA Research

Chart 2
Core Inflation Projections (YoY % Change)



Source: BLS, BEA, & BBVA Research

Inflation has not been evolving in line with FOMC expectations as much as the labor market, yet most members agreed that downward pressures on inflation are transitory. Concerns increased in the weeks leading up to the September meeting, with the deterioration in global markets risking a more prolonged period of lower inflation via the appreciation of the USD and declines in oil and other commodity prices. While not explicitly outlined in the meeting minutes, it is likely that Committee members weighed this factor more heavily in their decision not to announce a rate hike at the time.

The meeting minutes also revealed discussion on the risks to both initiating and delaying liftoff. Dovish participants were mostly concerned that increasing rates would put further downward pressure on inflation, ultimately hurting the Fed's credibility if inflation stays so low below their target for much longer after liftoff. These members also argued that monetary policy would be better off responding to upward rather than downward inflationary shocks, especially at the zero-lower bound.

The primary risk related to significantly delaying the rate hike was "an undesired buildup of inflationary pressures or economic and financial imbalances that would be costly to unwind and that eventually could have adverse consequences for economic growth." A rate hike sooner rather than later would allow for more gradual increases in the future and could also provide a boost of economic confidence to fuel real activity rather than slow it down.

All but one member agreed that conditions for liftoff had not yet been met, as the Committee's outlook did not change much throughout the intermeeting period. The FOMC felt it was "prudent to wait for additional information confirming that the economic outlook had not deteriorated and bolstering members' confidence that inflation would gradually move up toward 2 percent over the medium term." The one dissent came from Jeffrey Lacker (FRB Richmond) who argued that delaying the rate hike was too risky and that low real interest rates were no longer appropriate given current economic conditions.

Unfortunately, for the few hawks remaining on the Committee, expectations for stronger economic data do not appear to be materializing. Since the September meeting, most economic reports have fallen below consensus, with the month's weak job growth standing out as a hindrance to the Fed's plans for increasing rates by the end of this year.

Bottom Line: No Hike in October, and December's Odds on the Decline

The Fed's decision to delay the first federal funds rate hike in September was based on a wide range of economic data, yet it seems that there was heavy weight placed on inflation and the impact from weakness in the global economy. Before the September meeting, we expressed concerns that avoiding liftoff would open the door for the possibility that conditions could just get worse as we move through 4Q15. Unfortunately, these concerns are becoming a reality, and it is not clear whether we will see much improvement in the coming months. This may make it even more difficult for the FOMC to justify a rate hike by the end of the year, and may force the Fed to hold off until 2016, which most members still say they would like to avoid. At this point, the chances of a rate hike at the October 27th- 28th meeting are near zero, and the odds for December are quickly falling. In order to be completely confident on a December liftoff, the Fed will need to see significant improvement in a variety of economic data. Furthermore, increasing fiscal uncertainty and the threat of another government shutdown by mid-December may force the Fed to hold off on a major monetary policy move, as this has been an influential factor in the past.

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