Central Banks

FOMC Minutes: December 15th – 16th Meeting

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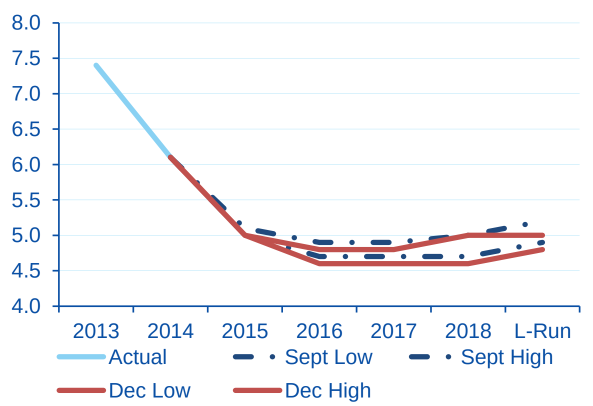
Liftoff a “Close Call” for Some Members as Inflation Uncertainty Lingers

- **Renewed downward pressure on oil prices and strong USD leading inflation concerns**
- **Members agree on gradual approach in order to ensure continued economic improvement**
- **Next rate increase expected in 2Q16 as FOMC waits to assess the lagged impact of liftoff**

December’s FOMC meeting minutes detailed the discussion behind the long-awaited federal funds rate hike. Review of economic and financial conditions proved to “almost all participants” that this was an appropriate time to begin the policy normalization process. Despite the unanimous vote, there was some uncertainty in the discussion, with the decision to raise rates “a close call” for some members due to their concerns on low inflation. However, participants were comfortable moving forward with the decision as long as the statement emphasized that monetary policy would remain accommodative and that the Committee would continue to monitor and respond to incoming economic data as appropriate.

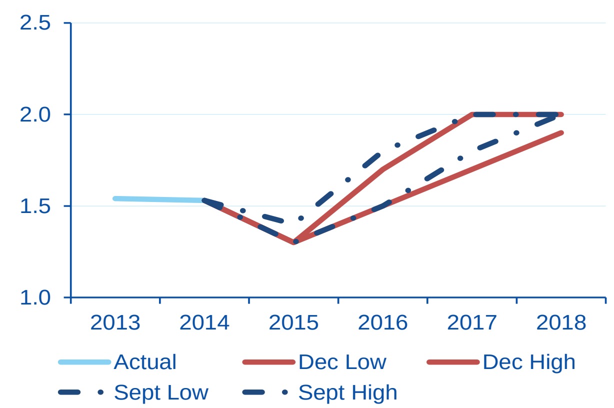
In general, FOMC participants felt that economic conditions for liftoff had been met. Most notably, the Committee confirmed their prior assessment that “underutilization of labor resources had diminished appreciably since early in the year.” This, along with long-run inflation expectations remaining stable, convinced the FOMC to a point that “nearly all participants were now reasonably confident that inflation would move back to 2 percent over the medium term.” Still, some members expressed concerns on inflation, including the renewed downward pressures on oil prices as well as the ongoing impact of the strong USD appreciation. This may not have been enough to stop the first rate hike but will certainly play a role in the discussion surrounding any rate increases in the coming year.

Chart 1
Unemployment Rate, 4Q %
(Central Tendency)



Source: FRB & BBVA Research

Chart 2
Core PCE Inflation, 4Q % Change
(Central Tendency)



Source: FRB & BBVA Research

The meeting minutes highlighted several reasons why the FOMC agreed on a gradual approach to policy normalization moving forward. Maintaining an accommodative stance of monetary policy would help ensure continued labor market improvement and help “exert upward pressure on inflation.” The Committee also pointed out that it might take some time for inflationary pressure to show up in the actual data, so a gradual pace of normalization would better allow policymakers to assess the economy’s response to higher interest rates. With the neutral short-term real rate close to zero and expected to rise only slowly, FOMC members felt that a gradual pace of rate increases “could help minimize the risk of having to respond to a negative economic shock while the policy rate remained near its effective lower bound.”

Bottom Line: Fed Waiting to See Liftoff’s Impact Before Next Rate Increase

The Fed’s decision to increase rates in December may have been unanimous, but that does not mean that there won’t be any contention in future meetings. December’s meeting minutes hinted at lingering uncertainty within the Committee, particularly related to the lack of upward inflationary pressure materializing in the economy. In order to move forward with liftoff, members wanted to be certain that the statement and any future communication emphasized “the potential need to accelerate or slow the pace of normalization as the economic outlook evolved.” They also wanted to make sure it was clear that they were not committing to a specific pace or size of adjustments with the understanding that the future path of interest rates could become flatter/steeper if economic activity strayed negatively/positively from their outlook. This suggests that the FOMC will wait at least a few months before moving ahead with the second rate hike, which we expect to come in 2Q16. We expect that the federal funds rate will reach 1.0% by the end of 2016.