Central Banks

FOMC Statement: September 20-21th Meeting

Boyd Nash-Stacey

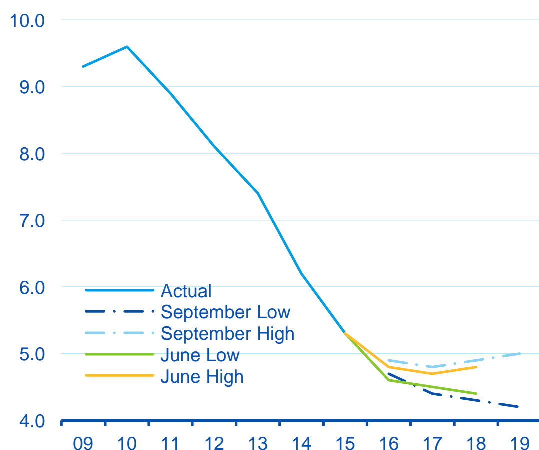
Despite uptick in number of dissenters FOMC remains on course for December

- **FOMC postpones rate hike, but opens door for increases in 2016**
- **Projections and dissents underlie growing divergence of opinions of "new normal"**
- **Minutes will shed light on pace of normalization, but December remains target for next hike**

As we expected, the FOMC at their September meeting chose to further delay rate increases for a sixth consecutive meeting, judging that conditions were closer to warrant policy normalization, but that "for the time being, to wait for further evidence of continued progress toward its objectives." The indefinite pause leaves the federal fund at 0.25-0.50%. Despite the market backdrop prior to the meeting being one of the calmest in recent memory, Yellen stated that muted inflationary pressures, a slower uptake in the remaining slack in the labor market and the fact that the committee now judges that the stance of monetary policy as less accommodative due to lower perceived equilibrium rates justified delaying policy normalization temporarily.

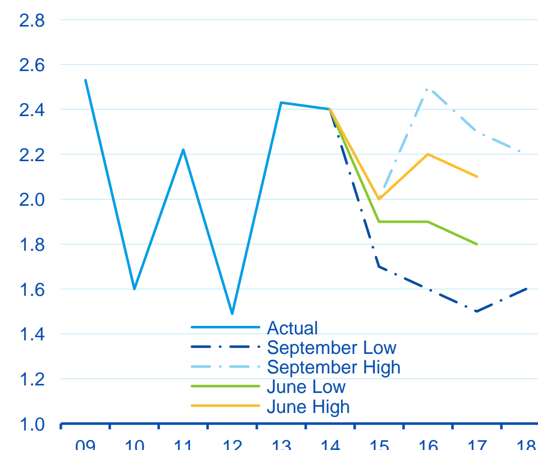
At the press conference Yellen tried to downplay the large dissenting block—the 3 dissenting votes in September's meeting is the most since 2014— saying that the committee remained unified in their assessment of current conditions, claiming that there is far less disagreement than would be implied from recent speeches (and voting). Furthermore, an excerpt from Yellen's speech in Jackson Hole made it into the statement, suggesting that the "case for an increase in the federal funds rate has strengthened". For the time being, it appears there is enough dovish support left to unify behind Yellen's more upbeat, but cautious outlook. She did, however, soften that perspective implying that there was a wide range of opinions on the "new normal."

Chart 1
Range of Unemployment Rate Forecasts



Source: FRB & BBVA Research

Chart 2
Range of GDP Forecasts

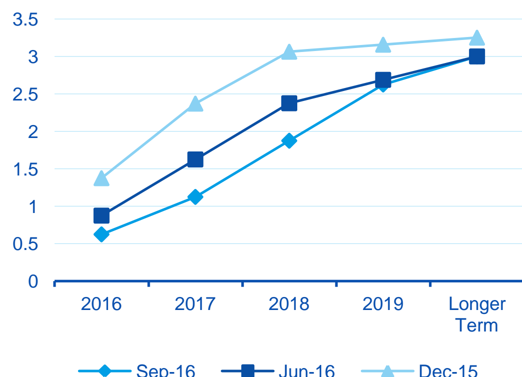


Source: FRB & BBVA Research

As much as the opinions regarding how structural forces differ, the summary of economic projections suggests most members long-run views have tilted to the downside. In fact, only the high end of the longer run range of projections for GDP were revised down, bringing the median projection down to 1.8% from 2.0% in June. In addition, the new implied path of the federal funds rate suggests that a majority believe that with lower equilibrium real interest rates, monetary policy is not overly accommodative; this is reflected in the shallower path of the federal funds rate. Yellen also aligned herself with Brainard's recent comments, highlighting in her press conference that near term risks to monetary policy are asymmetric and that the Fed would have little room to respond to a deterioration in labor market conditions. Taken together, this suggests that Yellen does not foresee any immediate risks to a more gradual normalization path.

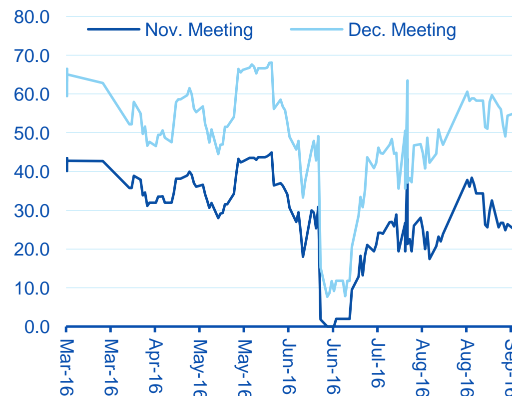
Nevertheless, markets took the news in stride with only modest changes after the announcement and press conference. The ho-hum response is no surprise given that consensus had shifted in the run-up to meeting. Post-meeting, markets continue to align with our baseline for one 25bp rate increase in December. Going forward, more optimistic sentiment about the current strength of the economy will leave the doves little room to maneuver out of hikes in 2016. Even the most dovish members will have a hard time convincing markets and other members that the pace of job growth seen over the last quarter is not sufficient enough to remove any remaining slack and that delaying rate hikes would be anything other than throwing good money after bad.

Chart 3
Median Projection of Federal Funds Rate



Source: FRB & BBVA Research

Chart 4
Market Implied Probability of Rate Increases, %



Source: Bloomberg & BBVA Research

Bottom Line: Markets primed for December following FOMC meeting

While the FOMC left rates unchanged at their September meeting, buying themselves some time until after the election, the statement, as we expected, prepared markets for a December rate hike. Despite having three dissenting votes, Yellen confirmed that short-run expectations are unifying around one increase this year. However, the committee's federal fund rate projections now imply a shallower pace of normalization. Uncertainty over the sustainability of the current recovery and growing divergence of opinions on the "new normal" underlie the downshift. As a result, a more pessimistic view of longer run potential and lower equilibrium interest rate projections increase probability of a more gradual tightening cycle.

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