BBVA Research

United States

FOMC Minutes: March 19-20, Meeting

Nathaniel Karp and Boyd Nash-Stacey

According to the minutes, members expect the pace of economic expansion to moderate in 2019, mainly due to weaker global growth and a smaller impact from fiscal stimulus. On inflation, although members expect inflation to converge with the 2% target in the new few years, they indicated that achieving their objective on a sustained basis could be problematic if inflation expectations remain at their current level. Meanwhile, although participants acknowledged that financial conditions had improved since year-end 2018, in part due to Fed's communication, they expressed concerns on the flattening of the yield curve. However, some members indicated that the relationship between an inverted yield curve and economic performance could be less reliable in the current environment of unusually low level of term premiums. Participants expressed concerns on the high leverage of the business sector and elevated uncertainty related to ongoing trade talks and Brexit. Other risks include "a greater-than-expected economic slowdown in Europe and China, persistence of the softness in spending, or a sharp falloff in fiscal stimulus".

Considering increased uncertainty around the economic outlook amid muted inflationary pressures, a majority of participants expressed that the best option for monetary policy would be to leave the interest rate unchanged throughout 2019. In fact, several participants noted that, "the current target range for the federal funds rate was close to their estimates of its longer-run neutral level" and the fed funds rate was "likely to remain on a very flat trajectory as reflecting other factors, such as low estimates of the longer-run neutral real interest rate or risk-management considerations." However, some participants believe that if economic conditions evolve as expected, they would consider rising interest rates later this year. In fact, a few officials indicated that lower interest rates for a prolonged period could generate financial stability risks.

Bottom line:

Today's minutes are consistent with our view that while risks are tilted to the downside there is still a possibility for a rate hike in 2H19 if economic conditions improve, inflation picks up and global uncertainty diminishes. However, if conditions do not improve the probability of a prolonged pause is high. Moreover, if risks to the downside intensify and the probability of a U.S. recession rises, the Fed would cut rates. This wide array of outcomes underscores the uncertainty surrounding the outlook for monetary policy.

Chart 1. Fed Funds Futures, %

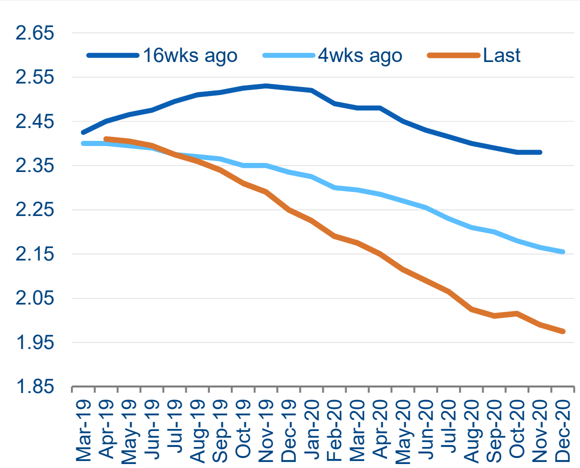
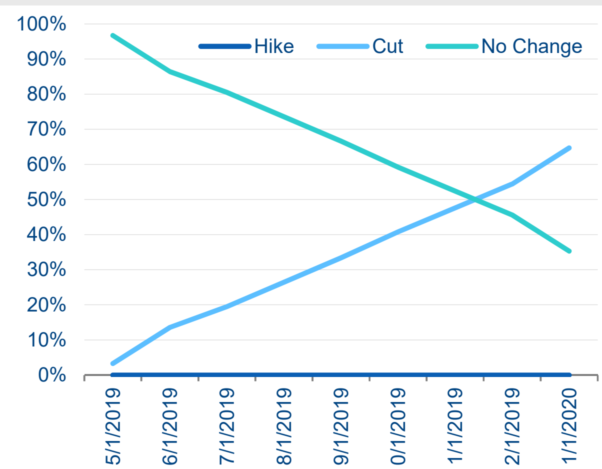


Chart 2. Fed Funds Probability, %



Source: BBVA Research and Bloomberg

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