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Fed Watch

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Economic Analysis

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Kim Fraser
kim.fraser@bbvacompass.com

Nathaniel Karp
nathaniel.karp@bbvacompass.com

FOMC Minutes: June 18th-19th Meeting

Members Afraid of Commitment to QE3 Timeline

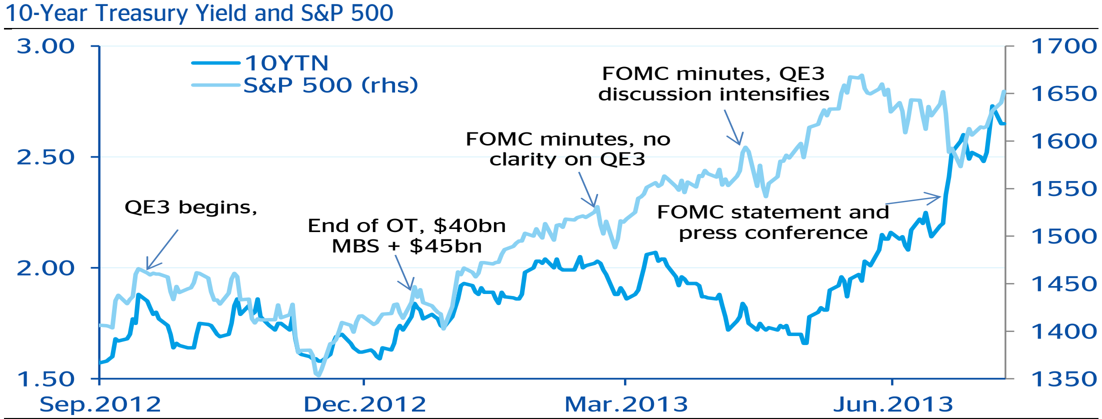
- **Committee hesitant to divulge too many details in press conference**
- **Many still looking for further economic improvement before tapering**
- **Talk of an exit strategy seems "premature"**

Monetary policy has been at the center of all the hustle and bustle as of late. The June 19th FOMC statement and press conference caused quite a surprising stir, and subsequent Fedspeak was geared toward calming markets and correcting this "overreaction" (see last Fed Watch). With the release of the corresponding meeting minutes, we gain some insight as to the Fed's views on recent economic activity and the strategic details that were revealed in Bernanke's press conference.

Rising interest rates had sparked some discussion leading up to the June meeting, with FOMC members attributing most of the increase to an improved economic outlook. Still, there was definitely cause for concern within the Committee, with many members concerned that higher rates could limit the recovery's momentum. Other concerns included the impact on financial institutions and the potential for excessive risk taking that could affect asset prices.

With the release of the Summary of Economic Projections, the FOMC agreed that economic conditions continued to improve. Thus, many members felt it necessary to clarify the future plans for QE3, though some remained hesitant to announce such a timeline that might "limit the Committee's flexibility in adjusting asset purchases in response to changes in economic conditions." Others argued that such an announcement might be misunderstood as part of the Fed's exit from their accommodative monetary policy stance. For future communication related to the asset purchase program, the committee agreed to always make the distinction with any decisions regarding the federal funds rate. To that end, some FOMC members felt that the Chairman's press conference was an appropriate venue to relay the Committee's projections for QE3, though we know now that the response was not quite what was intended. In fact, some participants warned in the meeting that it could be difficult to convey such clarity without committing to a strict timeline.

Chart 1
10-Year Treasury Yield and S&P 500



Source: BBVA Research, WSJ, & FRB

Overall, most FOMC members agreed that maintaining the current pace of purchases would be appropriate until they saw further improvement in the labor market, with one member (Bullard) against any form of tapering until inflation moved closer toward the 2% target. Approximately half of FOMC participants felt that it would be appropriate to end QE3 by late 2013, with many others favoring purchases continuing into 2014. A few members did argue that slowing asset purchases would have been appropriate at this June meeting. While the Committee will continue to assess the costs and benefits of QE3, one participant noted that it would be necessary to "explore other options for providing appropriate monetary policy accommodation" if QE3 were to end solely due to potential negative consequences outweighing the positive.

Discussions on the exit strategy were minimal given that the implementation is believed to be far off, with some members suggesting that related dialogue now was "premature." The Committee agreed that the principles laid out in 2011 could still be applicable in the broad sense but that many of the details of the eventual normalization process would most likely be different than what was originally proposed. In terms of the balance sheet composition, most FOMC members are in favor of holding mostly long-term Treasuries, selling off MBS only when it might be necessary "in the longer run to reduce or eliminate residual holdings."

Bottom line: FOMC Still Uncertain on Short-Term Policy Action

The FOMC meeting minutes did not quite live up to expectations for clarifying Bernanke's press conference comments. In fact, the details suggest that decisions related to communicating QE3, and the progress of the program itself, remain very much up in the air. Still, our expectations remain unchanged for tapering of asset purchases to begin in late 3Q13, with QE3 concluding in 1H14, assuming that economic activity continues to improve gradually. Based on the latest Fedspeak and these meeting minutes, it is clear that the FOMC is ready and willing to adjust as necessary should economic conditions stray off course, for better or for worse. Furthermore, the Fed will surely be more cautious in communication transparency moving forward.