Central Banks

FOMC Statement: July 29th – 30th

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Tapering on Track with Another Reduction in Asset Purchases

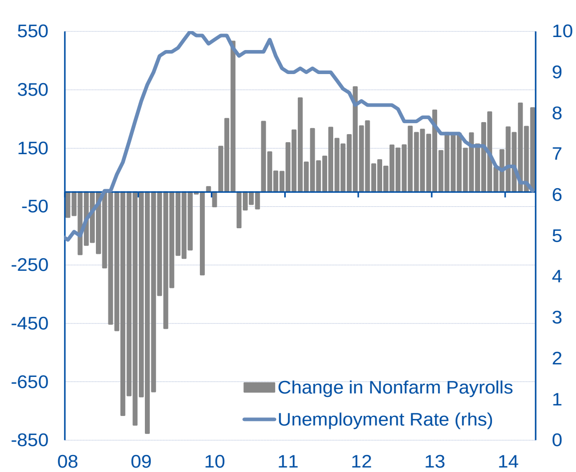
- **QE3 trimmed to $25bn in monthly purchases**
- **Forward guidance kept unchanged while worries on "persistently" low inflation faded away**
- **Plosser dissented, advocating for an earlier move towards policy tightening**

The FOMC maintained the $10bn reduction of the pace of asset purchases, reducing the monthly purchases of mortgage-backed securities and longer-term Treasury securities to $10bn and $15bn, respectively. The decision to further trim the monthly pace of QE3 came on the heels of a 4% GDP growth rate report for 2Q14, a highly anticipated rebound after the first quarter economy wide slowdown (U.S. GDP Flash). The "measured step" tapering is projected to stay on the pre-planned course, ending the asset purchase program in October 2014.

The FOMC statement upgraded the economic outlook referencing further decline in the unemployment rate and "advancing" of business fixed investment. At the same time, the Committee remained cautious of painting too bright of an economic picture, stating that "significant underutilization of labor resources" still lingers.

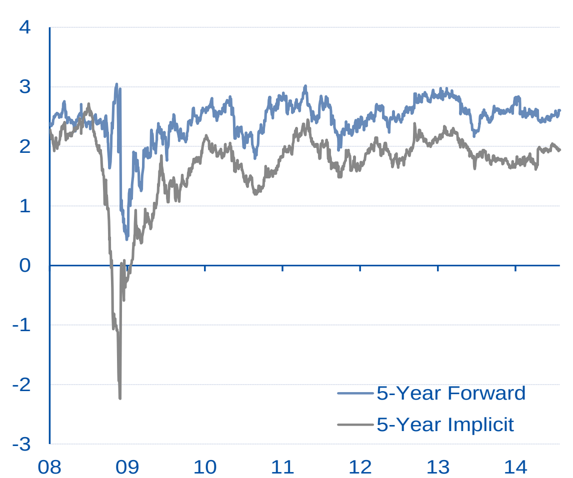
Most importantly, the Committee indicated that its concern regarding inflation being "persistently below its 2 percent objective" has faded, stating that "inflation has moved somewhat closer to the Committee's longer-run objective," and "[the Committee] judges that the likelihood of inflation running persistently below 2 percent has diminished somewhat."

Chart 1
Unemployment Rate and Nonfarm Payrolls (% and MoM Change in K)



Source: BLS & BBVA Research

Chart 2
Inflation Expectations (%)



Source: FRB & BBVA Research

Plosser (FRB Philadelphia) voted against the FOMC action objecting to the wording of the forward guidance on the timing of the first federal funds rate increase. He raised concern that the current forward guidance language regarding the implied trajectory of the federal funds rate is “time dependent and does not reflect the considerable economic progress that has been made toward the Committee's goals.”

Bottom Line: Fed to Maintain Discretionary and Data Dependent Policy

The FOMC most likely will continue with “prudent planning” of an exit strategy. The key aspects of the Committee’s deliberations on the craftsmanship of forward guidance, on how to convey the trajectory of the federal funds rate, and on the balance sheet normalization roadmap are expected to be communicated in the FOMC minutes. Nonetheless, the Fed is expected to keep in place the discretionary and data dependent policy. As such, consistent with our prior projections, we expect the gradual tapering process to come to an end in 4Q14 and the first rate hike to occur in mid-2015.