Central Banks

FOMC Minutes: April 26th – 27th Meeting

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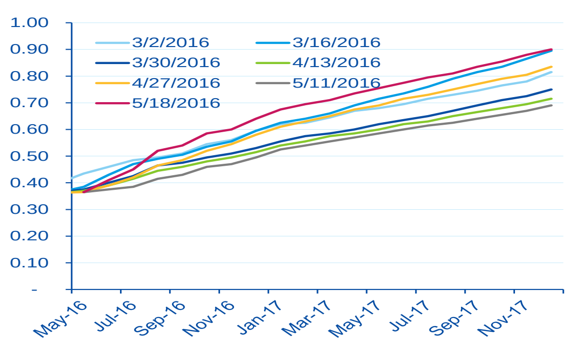
Minutes Leave the Door Open for a June Rate Increase

- **Weak 1Q16 activity supported the dovish dominance at April's meeting, with concerns over whether or not momentum will actually pickup throughout the year**
- **Hawkish FOMC members argue that further delays could be confusing to the public in regards to their data-dependent strategy and may ultimately hurt their credibility**
- **Fed communication will continue to signal the possibility of a June move, helping to better align market expectations along the way**

The minutes from April's FOMC meeting serve as another step forward in the quest towards a June rate hike. Adding to the recent bout of seemingly hawkish Fedspeak, the details of the minutes reveal increasing support for another policy move in the near future. Labor market conditions have improved, inflation is moving towards the Fed's target, and global risks have declined. All that is left to satisfy appropriate rate hike conditions for a June move are market expectations, which have now jumped to about 30% from close to zero a few weeks ago.

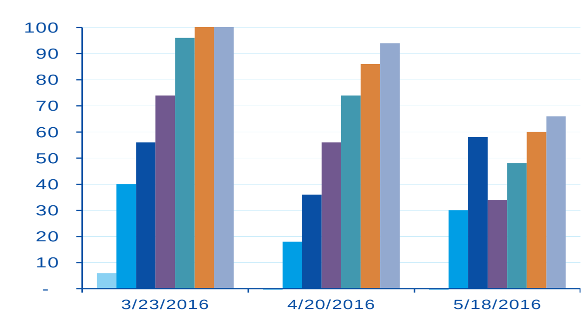
Committee members outlined multiple reasons for why the timing would be appropriate for a rate hike announcement at the June meeting. Along with the argument that maximum employment conditions had mostly been met, there seemed to be "greater confidence that inflation would rise to 2 percent over the medium term." Furthermore, "downside risks associated with global economic and financial developments had diminished substantially since early this year." Hawkish FOMC members also argued that delaying monetary policy action sends a confusing signal to the public about what specific conditions are required and/or considered under the Fed's data-dependent strategy, ultimately hurting their credibility. With rates deviating more and more from calculated benchmarks, the Fed could be caught in a position where they would need to raise rates too quickly in the future in order to fight off inflationary pressures. Finally, holding firm in their current highly accommodative policy stance could encourage "imprudent risk-taking in financial markets."

Chart 1
Federal Funds Rate Futures (%)



Source: Bloomberg & BBVA Research

Chart 2
Federal Funds Rate Futures Implied Probabilities (Second 25bp, %)



Source: Bloomberg & BBVA Research

However, the doves outweighed the hawks at April's meeting, and it is still unclear whether this will be the case in June. The argument to "proceed cautiously" has worked thus far but might not hold up to the hawks' reasoning in future meetings. Furthermore, doves continue to insist that risks are tilted to the downside and "still warranted close monitoring" – for inflation and regarding global economic developments. The doves do have some justification when considering the weak start to the year, unsure of whether or not the poor first quarter performance reflects "a loss of momentum" that would deter employment and inflation from continuing on the path towards their objectives. While they see that the costs are low in "maintaining a patient posture", some still argue that there are risks of waiting too long given the "lags with which monetary policy affects the economy."

For now, the only certainty is that the Committee remains divided, though the minutes were clear to leave the door open for the possibility of raising rates at the June meeting. It is important to remember that this is just the second of many future rate hikes to come, so the Fed does not need all indicators to already be at their target. In general, they just need the data to be convincing enough that eventually conditions will meet their objectives, and April's meeting minutes are encouraging in that direction.

Bottom Line: June Remains a Live Meeting for the Divided FOMC

Details from April's FOMC meeting do not strongly point to a clear decision one way or the other, but they have reemphasized the fact that June remains a live meeting. Markets had seemed to forget that fact in recent weeks, yet the minutes have helped better align expectations. Yellen and her colleagues have emphasized the importance of the overall path of interest rates rather than just each individual move, but the longer they wait to hike again, the more weight they are putting on the individual 25 basis point moves and making each nearly as important and anxiety-fueled as the first hike back in December. As always, the Fed will need to continue communicating clearly in order to make sure that market expectations are not too low as to prevent any chance of a move in future meetings.