

ECONOMIC ANALYSIS

Interpreting the Fed speak: FOMC minutes

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The sentiments in FOMC meeting minutes reveal the decision-making process of monetary policies and have a persistent effect on the financial market.

In [our previous economic watch](#), we discussed the quantitative measure of sentiments in FOMC statements after each meeting. In this economic watch, we will proceed to discuss the sentiments in FOMC meeting minutes and try to shed more light on the decision-making process of monetary authorities.

FOMC minutes and monetary policy

After each Federal Open Market Committee (FOMC) meeting, the Federal Reserve Board releases two important documents on the meeting: the statement and the minutes. Those two documents have different characteristics and serve different purposes. The statement is immediately released after the meeting summarizing the committee's latest policy in a few short paragraphs with a rigid style. Undoubtedly, the timely release and succinct style help market participants quickly grasp the decision of the central bank. Yet it reveals little information on the policy-making process, which could be as important as the policy itself in terms of shaping market expectations. Unlike the FOMC statement, the meeting minutes are generally published three weeks after the meeting and explain monetary policy in an elaborate manner. In this way, FOMC meeting minutes complement the statement and reveal much needed information on the policy-making process that could guide market expectations. Figure 1 compares the average number of words used in FOMC statements and meeting minutes, and Figure 2 compares the average number of words with sentiments. We can see that the meeting minutes have many more words than the statements and thus should carry more information on monetary policy.

In the previous economic watch, we showed that the sentiments in FOMC statements are significantly linked to the macro-economy and monetary policies. To further explore this relationship, we plot the trend of different sentiments in FOMC meeting minutes in Figures 3, 4, and 5 with the same quantitative measure. We find that some patterns in FOMC statements still hold for FOMC meeting minutes. For example, the positive sentiment increased after the Great Recession, while the negative sentiment decreased, and the uncertain sentiment peaked before the Great Recession, reflecting in part the implied bias of being more cautious when conditions are stronger and more optimistic when conditions are weak. On the other hand, we find that the relationship between the dates of key FOMC decisions (the start and end dates of QE's, for example) and the sentiments in minutes is not as obvious as in statements. This shows that the Fed's tone is more nuanced in the minutes than in the statement, possibly because unlike the statement, which only briefly demonstrates the final decision and the need to reach consensus with limited space for words and ideas, the minutes have to include opinions from

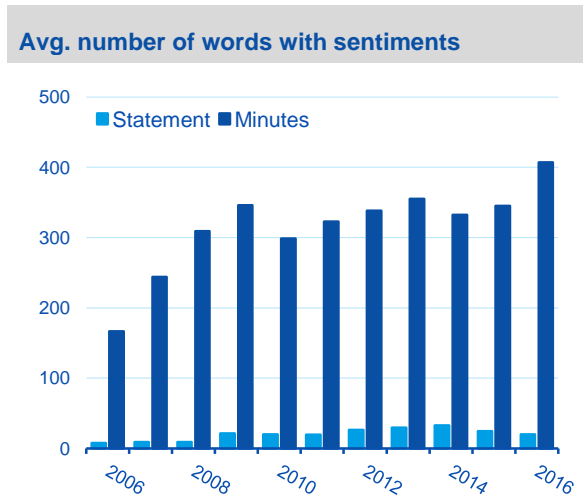
both the doves and hawks of the voting members, with the advantage of providing contrasting views in greater detail.

Figure 1



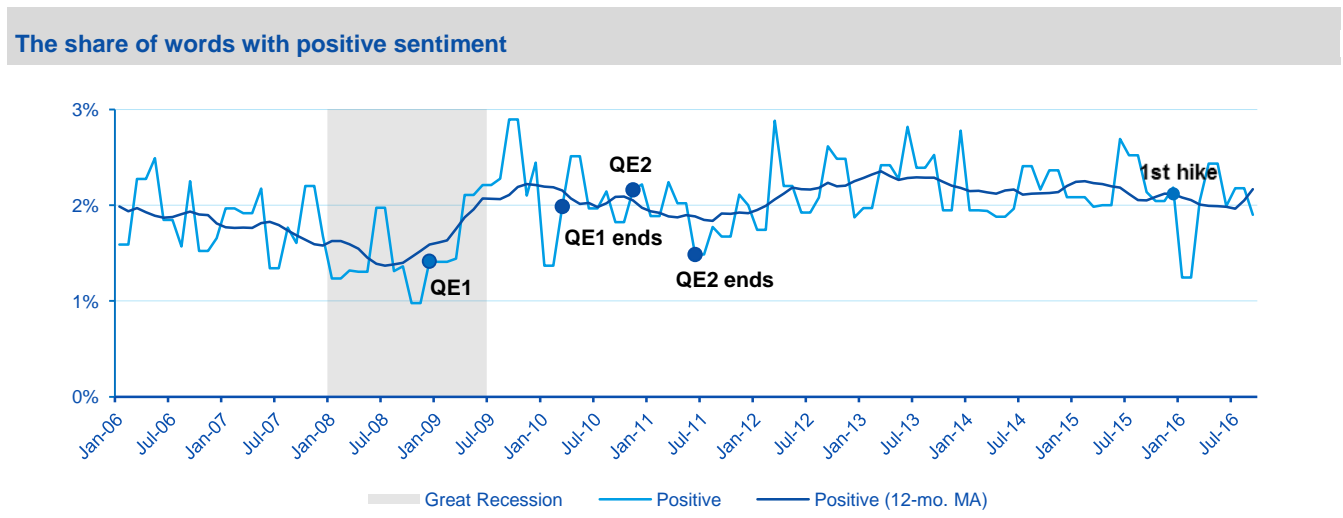
Source: FOMC & BBVA Research

Figure 2



Source: FOMC & BBVA Research

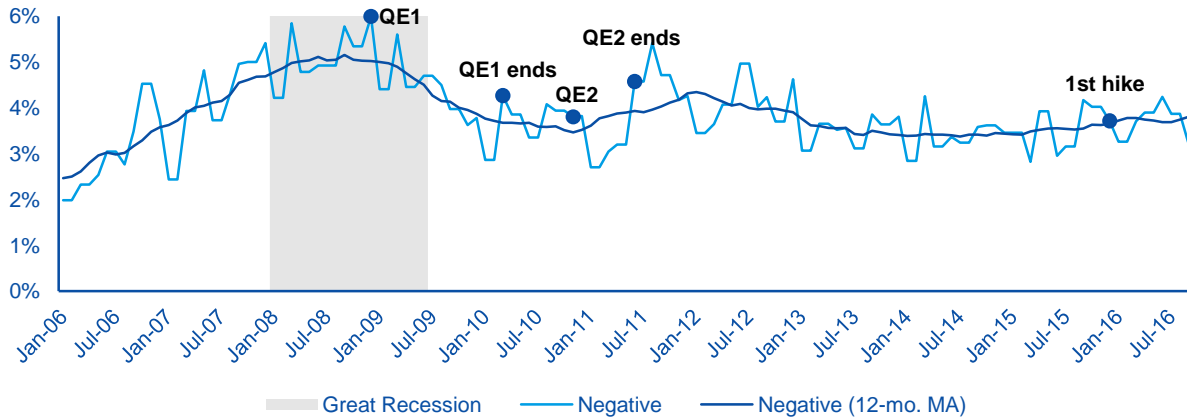
Figure 3



Source: FRB & BBVA Research

Figure 4

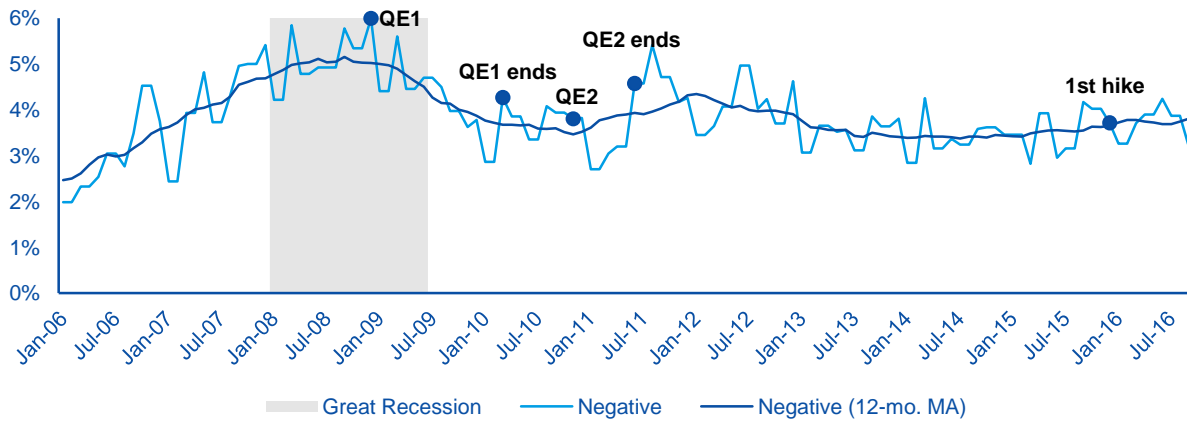
The share of words with negative sentiment



Source: FRB & BBVA Research

Figure 5

The share of words with uncertain sentiment



Source: FRB & BBVA Research

FOMC minutes and the financial market

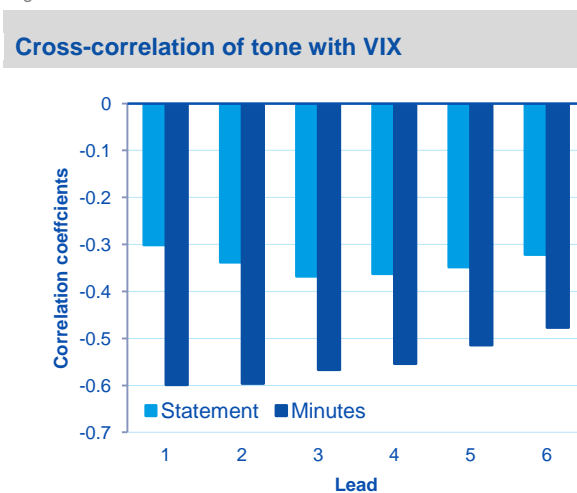
On the one hand, the FOMC statement and meeting minutes are instruments for the Fed’s communication and should both have a significant impact on the financial market. On the other hand, since FOMC meeting minutes reveal decision-making information on monetary policies rather than the policies themselves, their effect on the financial market is supposed to be more structural and persistent than the effect of the statement. Similar to Cannon (2015), we define the tone score in for each FOMC document as:

$$Tone = \#positive\ words / (\#positive + \#negative)$$

Obviously, higher value of the tone score will imply a more positive sentiment in the FOMC document (statement or meeting minutes).

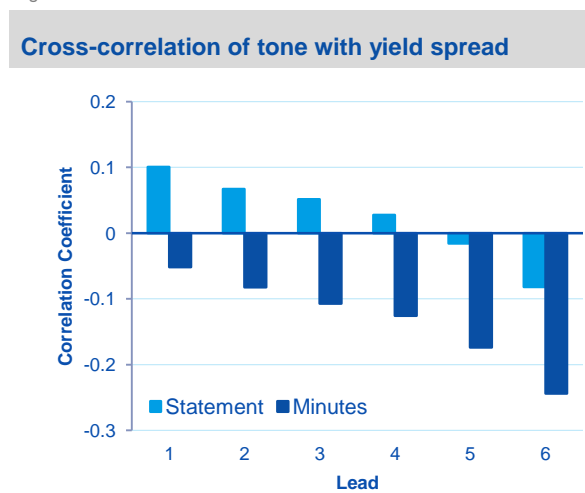
We use the cross-correlation coefficients of the tone score and financial variables to illustrate how the statement and minutes can affect the financial market differently. As Figure 6 shows, the sentiments in meeting minutes have a more persistently negative correlation with the VIX index than the sentiments in FOMC statements. Therefore, the negative sentiments in the minutes can raise the VIX index more than the negative sentiment in the FOMC statement. In other words, the decision-making process can be more influential than the decision itself. Similarly, in Figure 7, we show that the tone scores of statements are not significantly correlated with the Treasury Yield Spread (10-year treasury maturity minus 3-month treasury maturity), while the tone scores of minutes are negatively correlated. As VIX are mainly driven by short-term factors and treasury yield spread reflect expectations on both short-term and long-term factors, it is reasonable that the VIX responds strong to the tone than the yield spread.

Figure 6



Source: Haver & BBVA Research

Figure 7



Source: Haver & BBVA Research

Bottom line

FOMC meeting minutes reveal information on the central bank's policy-making process. Our sentiment analysis shows that the minutes play an important role in shaping market participants' expectations on monetary policy. Moreover, monetary policy-making can be more important than the policy itself. Meanwhile, as minutes have a more balanced tone than the statement and are not immediately released after the FOMC meeting, they could be used to smooth the transition of tones between two meetings. Also, we show that minutes and statement can have different impact to financial variables because they contain different information about the monetary policy.

References

Cannon, S., 2015. Sentiment of the FOMC: Unscripted. *Economic Review-Federal Reserve Bank of Kansas City*, p.5.

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