RESEARCH

Fed Watch

US

Houston, July 31, 2013
Economic Analysis

US

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FOMC Statement: July 30th – July 31st

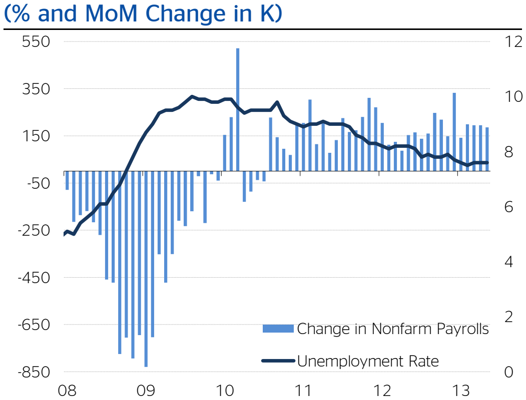
FOMC Message on QE3 Left Untouched to Relieve Tapering Pressure

- **The pace of asset purchases was left unchanged, as is our projection for the QE3 path**
- **FOMC policy guidance remained unchanged while some language changes "reaffirmed" that a highly accommodative policy for rates will remain far into the future**
- **FOMC assesses market expectations to be in line with Fed guidance**

The newly released statement did not contain any clues to lead market expectations on QE3 tapering. The paragraphs addressing the large scale asset purchases (LSAP) remained unchanged with a symmetric bias re-stating that "the Committee is prepared to increase or reduce the pace of its purchases." Re-emphasizing the data dependent path for the future of LSAP, the FOMC meeting announcement was in line with our expectation on maintaining the current pace of $85bn per month in asset purchases. Overall, the FOMC announcement conveyed the Committee's contentment with current market expectations and leaves us to think that the FOMC assessed market expectations to be in line with the policy guidance communication. Consequently, we maintain our projection of the Fed announcing tapering later in 3Q13 in the September 18th statement and in the Chairman's press conference.

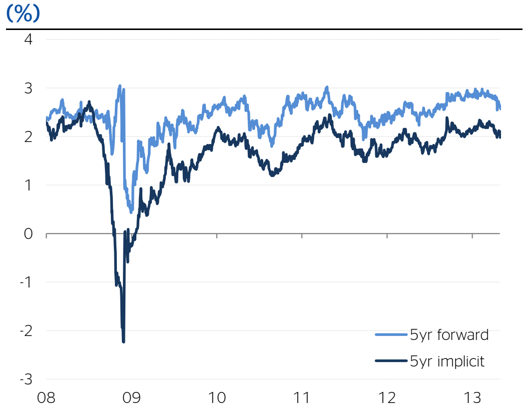
Our expectation of the QE3 timeline are further reaffirmed with today's release of 2Q13 GDP and the comprehensive revision of the past GDP data. The FOMC statement was preceded with the upside surprise to the 2Q13 real GDP growth as well as the revision of the recession and post-recession growth rates (U.S. GDP Flash). The 2Q13 advanced GDP showed a higher than expected growth rate (1.7% QoQ), while the 2010 – 2012 growth rate averaged at 2.38% (previously 2.14%). The positive economic outlook was also carried in the FOMC statement. There were two evidently optimistic changes in the announcement: the assessment of economic expansion change from a "*moderate pace*" to "*modest pace*" and the Committee's expectation of economic growth changed from "*will proceed* at a moderate pace" to "*will pick up* from its recent pace."

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



Source: FRB, BLS & BBVA Research

Chart 2
Inflation Expectations (%)

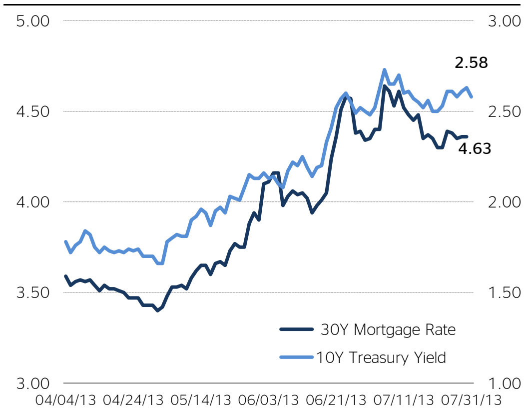


Source: FRB & BBVA Research

Along with the unchanged guidance on FOMC asset purchases, The Committee made substantial language changes to the statement, which carried a dovish undertone. One of those changes was the addition of concern with regard to mortgage rates that have "risen somewhat." Also, James Bullard's (Federal Reserve Bank of St. Louis) unease regarding the risk associated with the low inflation rate was addressed stating that "The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance." This made a difference to Bullard's vote as he voted for FOMC action, while his vote was against the action at last meeting. Last of all, the wording on the highly accommodative policy stance that will "remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens," changed from "the Committee *expects that*" to "the Committee today *reaffirmed its view*."

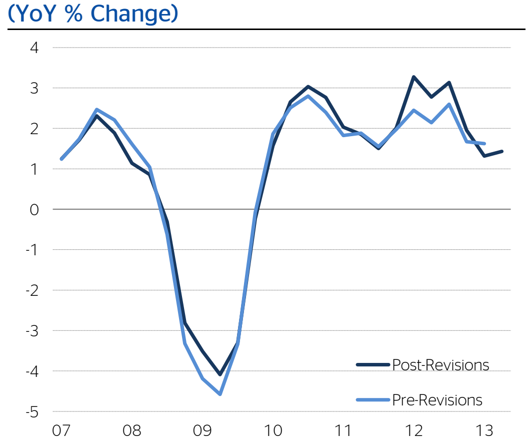
With Bullard switching sides, the single vote against the action was as expected from Ester George (Federal Reserve Bank of Kansas City), who remained concerned that increased monetary policy accommodation poses risks for economic and financial imbalances as well as for increased inflation expectations.

Chart 3
Long-Term Interest Rates (%)



Source: FRB, WSJ & BBVA Research

Chart 4
Real GDP Growth (YoY % Change)



Source: BEA & BBVA Research

Bottom line: QE3 timeline remains unchanged, with tapering to be announced in 3Q13

The FOMC did not announce any changes in the pace or composition of asset purchases. The forward guidance of LSAP remained unchanged as well. Many language changes of the statement did not matter much as the dovish statements were balanced with the optimistic economic outlook. Looking forward to the minutes, we expect to learn more on the stance of the Committee members regarding the timing of the scaling down of QE3. Presently, we maintain our baseline scenario of the Fed announcing tapering later in September. In addition, our expectation for the pace of scaling down remains unchanged.