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Fed Watch

US

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Economic Analysis

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FOMC Minutes: July 30th – July 31st

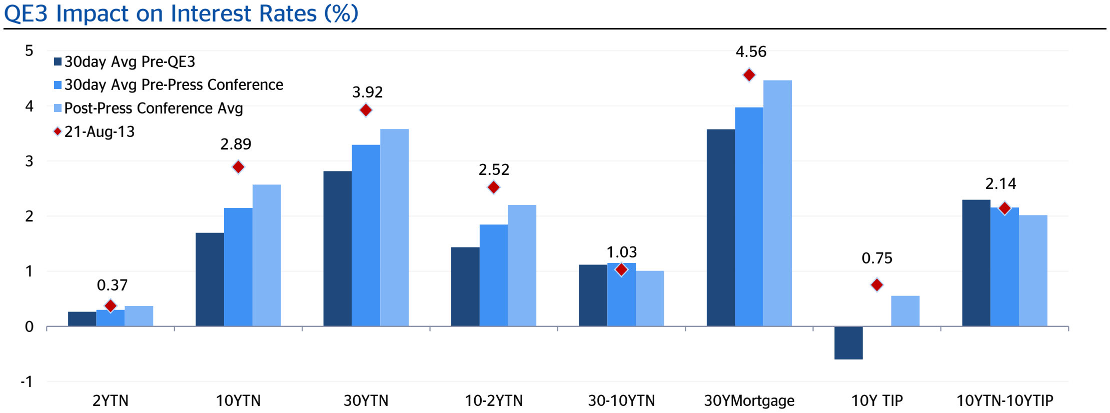
Minutes Reiterate on June Plan Regarding the Future Path of QE3

- **Minutes stated: "almost all participants" agreed that "the Committee would moderate the pace of its securities purchases later this year"**
- **Avoiding unintended consequences resulting from FOMC communication and forward guidance was in the center of the Committee's discussion**
- **FOMC participants' views diverged on how much emphasis should be put on the recent soft readings of inflation rate**
- **FOMC positively assessed the cumulative improvement in the labor market yet, as of July 31st, not enough to change the pace of QE3**

The FOMC minutes from the July 30th – 31st meeting convey the Committee's readiness to scale down the pace of QE3 purchases "later this year." Reflecting a positive economic outlook for the second half of 2013, the minutes stated that "almost all participants confirmed that they were broadly comfortable with the characterization of the contingent outlook of asset purchases that was presented in the June postmeeting press conference." The minutes reiterated that the pace of purchases is planned to be reduced in measured steps and brought to conclusion "around the middle of 2014."

The prevailing tapering discussion of the FOMC minutes triggered further decline in the broad indicators of equity markets coupled with a rise in the long term interest rates. The S&P500 decreased 9.55 points to 1642.80, a drop of 0.58%. At the same time, 10 Year Treasury Note increased 7 basis points to 2.89, reaching its highest level since July 2011. While today's yield on the 10 Year Treasury Note is 29 basis points above July 31st, as of July 31st only some participants were concerned with the negative economic consequences of tightening financial markets. On the contrary, some participants viewed it helpful for "unwinding of unsustainable speculative positions or an increase in term premiums from extraordinarily low levels."

Chart 1
QE3 Impact on Interest Rates (%)



Source: Federal Reserve & BBVA Research

The minutes revealed the FOMC participants' concern on when and how to communicate the Committee's plan with regard to scaling down the Large Scale Asset Purchases. The FOMC also discussed whether any changes to forward guidance are necessary. In order to avoid the risks of once again causing "rising uncertainty about the Committee's policy intentions," the FOMC came to the conclusion not to include any additional information regarding tapering within the policy statement. The discussion of possible changes to forward guidance was inconclusive as well. While some proposed adjustments to the unemployment threshold (lowering it) or enhancement to the inflation statement in order to strengthen or clarify the federal funds rate guidance, others expressed concern that any changes to the forward guidance can diminish the credibility or effectiveness of those thresholds as a policy tool.

Consistent with our view expressed earlier (Statement July 30-31), the Committee viewed market expectations of the future path for QE3 and the monetary policy in line with a number of FOMC participants. Consequently, the minutes also reveal the FOMC's dedication to clear and strong communication in order to avoid any potential surprises to both domestic and international financial markets. This reaffirms our projection of the QE3 timeline with tapering to be announced in the September 18th policy statement and press conference.

Overall, the path and the timeline for the pace of QE3 remain data-driven and vastly dependent on the FOMC's assessment of improvement in the labor market and on the inflation rate moving towards the Committee's 2 percent objective. As FOMC views on inflation rate diverge, the continued pattern of sub-2% inflation can delay the reduction in the pace of LSAP. Presently, while "few participants" consider the recent low inflation rate readings transitory and likely to be revised upward, a "number of others" interpret it as a sign of weak aggregate demand supporting a case for keeping QE3 purchases unchanged. According to the minutes, the Committee's labor market outlook remained positive. The members viewed cumulative improvement in the labor market as encouraging but as of July 31st "almost all Committee members agreed that a change in the purchase program was not yet appropriate."

Bottom line: QE3 scenario unchanged, with tapering to be announced in September

The FOMC July 30th – 31st minutes revealed the Committee's consensus regarding the future path of QE3 purchases. The minutes reiterated that the pace of purchases is planned to be reduced in measured steps and brought to conclusion in the middle of 2014. While the timing for QE3 tapering remains vastly data-driven, our QE3 scenario of the FOMC announcing tapering in September, as well as our expectation for the pace of scaling down remains unchanged. However, the September tapering announcement is contingent upon the subsiding of the FOMC's deflationary concerns.