RESEARCH

Fed Watch

US

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Economic Analysis

US

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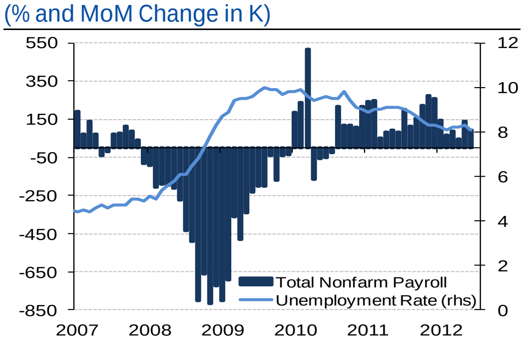
FOMC Minutes: September 12-13th

Details Reveal Individual Ideologies but a Common Goal

- Despite intense debates over additional policy accommodation, only one member voted against QE3 and extended policy guidance
- Short-term growth expectations were revised lower due to the Midwest drought, but a brighter outlook for Europe boosted medium-run forecasts
- The Fed will be on the sidelines for the next few months, waiting for Congress to address the fiscal cliff

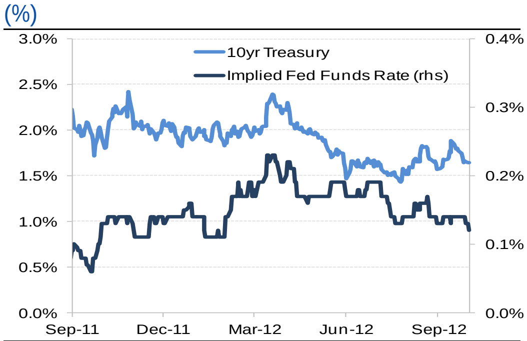
The September FOMC meeting was a decisive moment in regards to monetary policy accommodation, resulting in the announcement of QE3 and an extension of the interest rate policy guidance. Meeting minutes released today provide more details related to the strongly debated topic of QE3, which ultimately became a majority agreement by the end of the session. FOMC members presented a cost-benefit analysis of additional easing which suggested that asset purchases could be effective in "fostering more rapid progress toward the Committee's objectives" and that QE3 was unlikely to impact the Fed's ability to tighten policy when economic conditions should warrant such action. In general, Committee members concluded that the economy was unlikely to strengthen enough to generate "sustained improvement in labor markets conditions" without additional monetary policy accommodation. The open-ended strategy for MBS purchases was presented as a way to increase the policy's success in reducing unemployment and boosting economic confidence. Members in support of additional easing noted that QE3 would "emphasize the Committee's commitment to continued progress toward its dual mandate," thus increasing both business and consumer confidence. While most members agreed that additional large-scale asset purchases would boost the recovery, one participant felt that purchases of Treasuries were preferable to MBS. A few others also highlighted concerns regarding QE3's impact on financial markets and were less optimistic compared to prior rounds of quantitative easing. Another member felt that extended accommodation could influence "excessive risk-taking" and increase financial instability. Ultimately, most agreed that the aforementioned risks were manageable in the sense that current policy allowed for the Fed to make adjustments as necessary depending on changes in economic activity and/or members' cost-benefit analysis of additional purchases.

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



Source: Bureau of Labor Statistics & BBVA Research

Chart 2
10-Yr Treasury and 12M Fed Funds Expectations (%)



Source: Federal Reserve & BBVA Research

FOMC members also discussed at length the proposal to extend policy guidance. The main argument against this action was the use of a specific calendar date, which some members argued could be seen as a downgrade to the Committee's economic outlook rather than a means to support the ongoing recovery. Many suggested that they could replace the calendar date with a qualitative statement about the improved economic conditions that would warrant an increase in the target rate, yet members could not reach an agreement on the exact numerical thresholds or how to appropriately communicate these to the public. In the statement issued immediately after the meeting, the Committee emphasized that its highly accommodative stance will be appropriate even as economic growth picks up. The intent here was to improve communication and clarify that the extended policy guidance was intended to support a stronger economic recovery rather than suggest expectations for weakening activity.

The meeting minutes also provided additional details regarding the revised Summary of Economic Projections. In their assessment of current conditions, FOMC members noted that "economic activity continued to increase at a moderate pace in recent months." Growth projections for the medium-term were revised up on account of an improved outlook for Europe and for equity prices. However, the recent drought in the Midwest and the expected impact on farm output through the second half of 2012 led to a lower forecast for the short-term. As always, downside risks to growth remain prevalent and include deterioration in Europe, fiscal tightening in the U.S., and continued household deleveraging.

Bottom line: FOMC Looking at Congress to Make the Next Move

Now that the FOMC has maximized its policy accommodation for the time being, we do not expect much to come out of the October session. Members will likely continue discussing the effectiveness of QE3 and will closely monitor the impact on economic activity. In addition, the minutes from the September meeting noted that the Committee plans to discuss developments related to an FOMC consensus forecast and enhanced communication policies. Most importantly, with the upcoming meeting occurring only two weeks before the election, the Fed will sit back and wait for the political leaders to do their part. Bernanke and his colleagues have made it very clear that without some sort of compromise in Congress, monetary policy will be unable to prevent the economy from sliding into recession in 2013.