U.S. Fed Flash

Chair Yellen Testimony
Before the U.S. Congress Joint Economic Committee

- **Yellen's message remains dovish**
- **FOMC will give indication when the policy of reinvesting principal payments will stop**
- **Fed sees minor "reach for yield" with no observable risk of financial bubbles**

Despite that April's unemployment rate dropped to 6.3%, Yellen's message remained dovish at the testimony before the Congressional Joint Economic Committee. She stated that conditions in the labor market "are still far from satisfactory," reaffirming that "a high degree of monetary accommodation remains warranted."

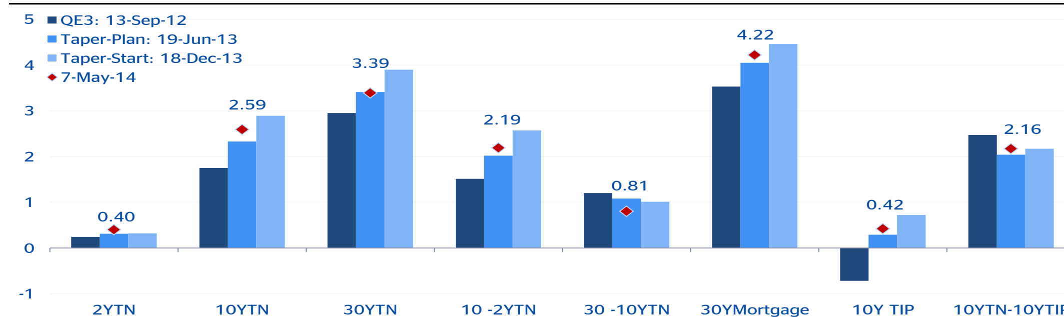
Pressured to answer questions on both the strategy and timing of Fed's exit, and on the process of balance sheet normalization, Yellen craftfully avoided direct answers by echoing the last FOMC statement that monetary policy will remain accommodative for a "considerable time" after QE3 ends. In addition, the Fed Chair did not commit to a preset course or timetable. However, the key takeaways on the Fed guidance are in line with our expectations on the course of monetary policy: ending the asset purchases program in the Fall; modification of forward guidance on re-investment policy; an increase in the interest rate on excess reserves in parallel with the federal funds rate hike; and, the use of new repo tools such as overnight, term and reverse repos through the policy normalization period. Yellen also re-confirmed the previously set plan to hold long-term securities, especially mortgage-backed securities (MBS), to maturity stating that MBS would not be sold "except to eliminate the residual." The likelihood of the Fed's balance sheet returning to the pre-crisis level at the end of the normalization process was not clearly confirmed and was left unanswered.

Nonethelss, Yellen stated that there were both international and domestic risks "prominent" enough to deter the Fed from the current course of policy and a gradual end to QE3. These risks encompass the "adverse developments abroad, such as heightened geopolitical tensions or an intensification of financial stresses in emerging market economies" and "recent flattening out in housing activity" in the U.S.

Yellen reassured the skeptics of the Congressional Committee that the stock market bubble is not a risk by stating that "we [FOMC] have targets and can detect stock market bubbles" and adding that "valuations for the equity market as a whole and other broad categories of assets, such as residential real estate, remain within historical norms."

We maintain our expectations of QE3 ending in 4Q14 and the first rate hike in mid-2015.

Chart 1
FOMC Announcements Impact on Interest Rates (%)



Source: Federal Reserve & BBVA Research

Shushanik Papanyan
shushanik.papanyan@bbvacompass.com
+1 713 831 7342

Nathaniel Karp
nathaniel.karp@bbvacompass.com
+1 713 881-0663

DISCLAIMER
This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research U.S. on behalf of itself and its affiliated companies (each BBVA Group Company) for distribution in the United States and the rest of the world and is provided for information purposes only. Within the US, BBVA operates primarily through its subsidiary Compass Bank. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document have been gathered or obtained from public sources, believed to be correct by the Company concerning their accuracy, completeness, and/or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.