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Instant Analysis

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Instant Analysis of Today's September FOMC Statement

FOMC keeps "considerable time" language in statement as I expected
Statement more dovish than markets had been bracing for
No sign of accelerated 2015 rate hikes in the statement
In contrast, Dot-Plot looks more hawkish for rate hikes in 2015 and 2016
FOMC announces another reduction in monthly asset purchases
Fed reducing asset purchases by $10 billion in October to $15 billion per month
Starting in October, Fed will buy Treasuries ($10B per month) and MBS ($5B per month)
Total asset purchases will stop following the October FOMC meeting
No upgrade of current economic conditions
Inflation still running below the Committee's long-run objective
Two Dissents: Charles Plosser & Richard Fisher
Markets mixed- S&P 500 up 0.1%, 10-Yr Treasury +2.2 bps to 2.61%, USD strengthens

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Confusion reigns as the Fed appears to be over communicating. The more hawkish dot-plot forecast on the Fed fund target rate doesn't jive with cut in the GDP growth outlook and dovish official statement. There was something for everyone in today's FOMC meeting materials: the statement, summary of economic and interest rate projections, and a description of the Fed's policy normalization plans. I would still keep my eye on the dot-plot and prepare for higher interest rates next year despite today's dovish tone. I continue to expect the first Fed funds rate hike from the FOMC sometime in the second quarter of next year. The pace of the hikes once they begin will probably be more aggressive than the markets have been pricing in so far.

First let's dive into the statement. The FOMC statement for September was barely altered from the July meeting. The FOMC noted that the economy continues to expand moderately, but there was no real upgrade of current economic conditions and its view on current inflation became somewhat more bearish, noting that inflation is still running below the Committee's long-run objective. QE asset purchases are expected to stop at the end of October. The Committee decided to move ahead with another $10 billion reduction in monthly asset purchases to $15 billion per month starting in October. This is down from $85 billion a month in purchases before the tapering began in January. The reductions in asset purchases were again evenly split between MBS and long-term Treasury bonds. In October the Fed will be buying $10 billion a month in Treasury securities and $5 billion a month in MBS and agency debt.

Of more interest was the new economic and interest rate projections released along with the FOMC statement, particularly the Fed funds rate "dot" plot. There was another downward adjustment to the central tendency forecast of GDP growth for 2014 and 2015, but this was somewhat offset by the unemployment rate that was expected to fall somewhat faster than forecast back in June. The outlook for future PCE inflation remains somewhat below the FOMC's objective over the next two years, about in-line with its expectations in June.

In contrast, and perhaps more worrying for the bond market, the Fed's "dot plot" of FOMC and Fed President expectations of the Fed funds rate path was more aggressive on 2015 and 2016 rate hikes than in June. Median expectation of the Fed funds rate at the end of 2015 was at 1.25 percent from 1.125 percent projected in June. By the end of 2016, the median expectation of the Fed funds rate was at 2.75 percent up from 2.5 percent in June. By the end of 2017, the median expectation of the Fed funds rate is nearing the long-run or neutral Fed funds target of 3.75 percent.

The FOMC's plan for policy normalization, when the time is appropriate, appears to be as advertised in the minutes from the July meeting. The Fed will set a higher range for the Fed funds target rate, primarily by adjusting the interest it pays on excess reserve balances. It will also use the overnight reverse repo market as necessary to help control short-term rates, but will phase this out when it is no longer needed. The Committee will begin gradually shrinking its balance sheet, by phasing out reinvestment of principle payments on its securities portfolio, sometime after it begins raising the Fed funds target rate. This will depend on the evolving economic and financial outlook. The Committee does not see selling agency MBS, though it left the door open for some limited sales in the longer-run to reduce residual holdings.

Markets were mixed on today's news. Treasury bond yields increased modestly across the maturity spectrum. The S&P 500 moved slightly higher, and the US dollar strengthened against major currencies.