December 17, 2014

Instant Analysis

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Instant Analysis of Today's December FOMC Statement

FOMC is getting serious about raising the Fed funds target rate in 2015
Yellen says liftoff could happen as soon as April 2015- though still data dependent
Dot-plot remains more hawkish than futures market expectations and FOMC statement
Three Dissents: 2 Hawks and 1 Dove (All the dissenters leave the FOMC next year)
Fractious FOMC hedges its bets with statement– pleases and confuses everyone
Almost, but not quite, gets rid of "considerable time" language
Keeps "considerable time" language in statement takes it out of forward guidance
Replaces "considerable time" with "the Fed can be patient" in forward guidance
Yellen says there has been "no change in policy guidance"
Upgrades assessment of current labor market conditions
Inflation decline still seen as transitory- monitoring inflation developments closely
Market jumps- S&P 500 +2.0%, 10-Yr Treasury +7.5 bps to 2.13%, USD strengthens

I am increasingly convinced that the wordsmithing of the FOMC statement is getting in the way of the Fed's ability to communicate clearly with the markets its forward guidance on the Fed funds target rate. Reading through the statement and witnessing the market's reaction, I initially read the statement as somewhat dovish and supportive of our later than consensus liftoff date for the Fed funds target rate. The FOMC left in the "considerable time" language in the statement, but replaced it in the forward guidance with "the committee judges that it can be patient in beginning to normalize the stance of monetary policy". Dissention appeared to reign with three dissents: two from the hawks, Fisher and Plosser, and one from the doves, Kocherlakota. Yellen appeared to initially back up my dovish assessment by mentioning early in her press conference that there was "no change in policy guidance" with the statement changes.

But then the Yellen comments got a lot more hawkish. The bombshell was that the Fed funds liftoff date could happen as soon as the April 2015 FOMC meeting. This is the earliest date I have ever heard Chair Yellen utter, and sooner than most FOMC members have dared utter, except for the diehard hawks. At the same time, the "Dot-Plot" from the Summary of Economic Projections, remains far more hawkish than the fed funds futures markets are forecasting. The median forecast of the FOMC is that the Fed funds target rate could be at 1.125 percent by the end of 2015, 2.5 percent by the end of 2016, and 3.625 by the end of 2017. Very similar to what the FOMC projected back in September.

The cognitive dissonance between a dovish FOMC statement and more hawkish forecast and comments from the Fed is giving me and the markets a migraine headache.

Bottom-line, the FOMC appears to be looking through the latest market turmoil and plunge in oil prices, expecting the impact on the U.S. economic outlook to be minor and possibly a net positive. While headline inflation will slow noticeably in early 2015, they see little impact on core-inflation and are not significantly altering their calculus on when to start normalizing short-term rates. The Fed sees a lower unemployment rate by the end of 2015 than it did back in September. Real GDP growth is expected to remain above trend over the next three years, though the inflation outlook was lowered. While the FOMC remains data dependent on when to start raising rates next year, the Fed appears more and more comfortable with their economic outlook and the improvements they are seeing in the U.S. labor market. Don't be surprised if they start raising rates sooner and more aggressively than the markets think. A Q2 rate hike from the Fed is now clearly on the table, sooner than I expected. I had been forecasting a September liftoff date for the Fed funds target rate due to lingering disinflation concerns. I find the stock market knee jerk rally in light of this as odd, unless the markets were expecting the Fed to hit the panic button given recent financial developments and are relieved by the FOMC's apparent policy consistency today and the apparent resilience of the U.S. economy in 2015. Going forward, we will be watching to see if the bond market finally follows the FOMC's lead by pricing in higher short-term rates.