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FOCUS NOTES

# March FOMC minutes: Higher federal funds rate expected by the end of this year

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The minutes of the March 17-18 FOMC meeting did not yield major surprises.[1] There was a considerable disparity of views between FOMC members around the timing of the first rate hike. A number of them argued in favor of a rate hike in June, but the majority appeared to be considering the first fed funds rate hike to be delivered in the second half of the year. Although the committee downgraded its GDP growth projections for the years 2015, 2016 and 2017,[2] it did acknowledge that the US labor market has made enough progress to justify the removal of the "patient" language from the forward guidance of the accompanying statement. As regards the pace of Fed rate tightening after the first hike, the committee made it clear that it will be slow and steady.

Key points of the March FOMC minutes include the following:

- As far as the timing of the first rate hike is concerned, the minutes highlighted that "several" FOMC participants were in favor of the first rate hike to take place in June, while a "couple" were of the view that the Central Bank should wait until 2016, amid concerns about the negative impact of a stronger dollar and lower energy prices on inflation. However, the majority of the FOMC members appeared to prefer the normalization process to start between September and December, provided that the economic outlook does not surprise negatively.

- FOMC participants noted that a number of risks to the global economic outlook could also weigh on US growth prospects, including geopolitical tensions, the economic slowdown in China and renewed Grexit jitters. Furthermore, they acknowledged that labor market conditions are broadly improving, but "a few" highlighted that subdued wage growth could prompt further reductions in their estimates for the natural rate of unemployment. It should be noted that more than half of the FOMC participants lowered their projections of the longer run (beyond 2017) rate of unemployment to 5.0-5.2%, from 5.2-5.5% previously.



[1] http://www.federalreserve.gov/monetarypolicy/fomcminutes20150318.htm

[2] GDP growth projections were revised as follows: for 2015 to 2.3-2.7% from 2.6-3.0% previously, for 2016 to 2.3-2.7% from 2.5-3.0%, and for 2017 to 2.0-2.4% from 2.3-2.5%.

- As soon as the FOMC embarks on a rate tightening cycle, it will continue to target a 25-basis point wide range for the fed funds rate, as opposed to targeting a point estimate as it did until October 2008. The interest paid on excess reserves (IOER) and the overnight reverse repo (O/N RRP) facility rate will be the upper and the lower boundary of the said range, respectively. In addition, the aggregate capacity of the O/N RRP facility will be temporarily elevated to facilitate monetary policy implementation.

Given the weaker than expected March nonfarm payrolls report released last week[3] and the Fed's downwardly revised projection of the longer run rate of unemployment, our baseline scenario is for the Central Bank to start its monetary normalization process in September, at the earliest. Nevertheless, we do not rule out entirely the Fed to delay the first interest rate increase until Q4 2015, especially if inflation remains well below its medium-term 2% inflation target.

[3] http://www.bls.gov/news.release/pdf/empsit.pdf

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