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Thoughts on the FOMC Statement

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"I generally think that people place far too much emphasis on the noise that arises from FOMC statements…."

Today's statement from the FOMC caused a bit of a stir in the markets. The S&P 500 was flat prior to the Fed's statement and quickly dipped –1% before recovering a bit. The statement was not well received and was reported by many as being a sign that the Fed would tighten sooner than expected. But I want to put things in the right perspective here before we shoot first and ask questions later.

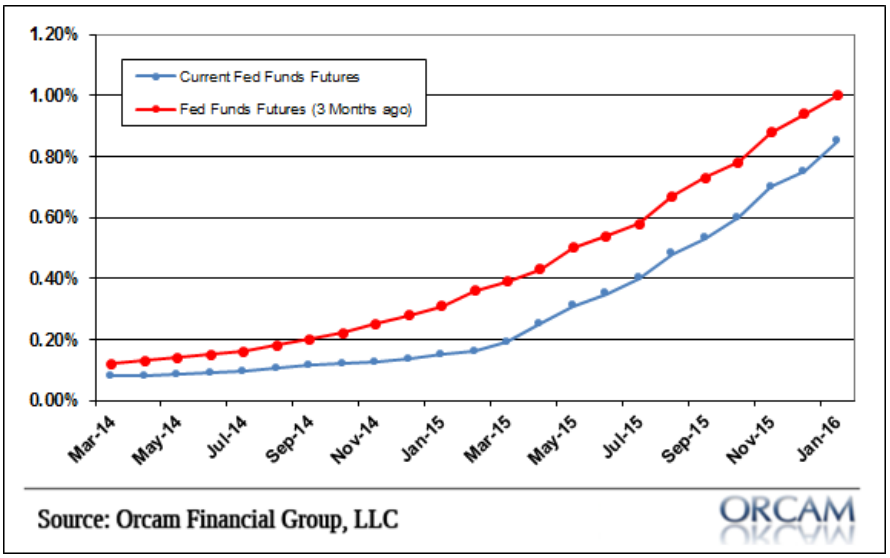
First of all, the Fed statement was very clear that the Fed is going to maintain an accommodative policy stance for quite a while to come. Here is the exact wording:

"When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run. "

These comments were later clarified in the press conference where Janet Yellen stated that "some time" would amount to 6 months. Then, in a later comment, she seemed to waffle on this position a bit:

"if I thought that was a situation we were likely to encounter in the next several years, we probably would have revised our forward guidance in a different way."

I feel like sometimes we read into the words of central bankers a bit too much, but tea leaf reading seems to be the strategic approach of the day…



Either way, I did not read this statement as being a sign that the Fed would tighten sooner than many think. And a little bit of rough guesstimation can put this in the right context:

- The Fed has been easing QE by $10B per meeting to a current pace of $55B in QE per month.
- If we look at the FOMC calendar we can see 6 more meetings this year.
- This means the Fed could taper by $10B per meeting until the October meeting where, let's be overly optimistic and assume they taper by $15B in this meeting to end QE.
- If we attach Yellen's 6 months to this timeframe then we are looking at a rate hike in March of 2015.

Of course, this timeline assumes that the economy will remain relatively robust until this time next year. That's certainly no guarantee. But more interestingly, if we look at the Fed Funds Futures curve we can see that the curve has already dropped pretty substantially in the last three months and the first rate hike isn't expected until about Q2 next year. That means bond markets are pretty much right on the dot in my opinion in terms of their timing for Fed tightening.

Said differently, today's meeting didn't change anything. The timing for rate hikes (what I would call the phase of the "real tightening") isn't altered by today's meeting. So markets are likely overreacting to the FOMC statement and reading too much into the statements by Yellen and the Fed.