Fed Minutes -- no message, therefore dovish

The Fed Minutes did not deliver anything new. In practice this is dovish as almost all market participants who expected a shift from the Statement/Press conference were on the hawkish side. No one expected a more dovish message so the hawks are caught offside. However we are talking smalls here.

Also there was plenty of concern expressed by Fed officials on growth and little concern about inflation.http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20140618.pdf

A few quotes in parentheses followed by my bulleted comments (all bolding mine):

"The staff's forecast for inflation in the near term was revised up a little as recent data showed somewhat faster increases in consumer prices than anticipated. **However, the medium-term projection for inflation was revised down slightly,** reflecting a reassessment by the staff of the underlying trend in inflation."

- No concern on inflation here, and the lowering of long term expectations a signal that the recent surge was viewed as temporary.

"While inflation was still seen as running below the Committee's longer-run objective, longer-run inflation expectations remained stable and the Committee anticipated that inflation would move back toward its 2 percent objective over the forecast period."

- Again emphasis on inflation below target, not that the recent surge suggests an alarming pickup.

"Most participants viewed the risks to the outlook for the economy, the labor market, and inflation as broadly balanced."

- Modest acknowledgment of strengthening economy.

"However, several participants read the recent soft information on retail sales and health-care spending as raising some concern about the underlying strength in consumer spending."

"The recovery in the housing sector was reported to have remained slow …"

"However, participants also discussed whether some recent trends in financial markets might suggest that investors were not appropriately taking account of risks in their investment decisions. In particular, **low implied volatility … as well as signs of increased risk-taking were viewed by some participants as an indication that market participants were not factoring in sufficient uncertainty about the path of the economy and monetary policy**. They agreed that the Committee should continue to carefully monitor financial conditions and to emphasize in its communications the dependence of its policy decisions on the evolution of the economic outlook; it was also pointed out that, where appropriate, supervisory measures should be applied to address excessive risk-taking and associated financial imbalances. At **monetary policy needed to continue to promote the favorable financial conditions required to support the economic expansion**."

- Last line is important – suggests that they do not want to derail financial market optimism too much, and indicates directly that they are concerned that tightening will derail the economy.

"**Many judged that slack remained elevated**, and a number of them thought it was greater than measured by the official unemployment rate… **several participants pointed** out that both long- and short-term unemployment and measures that include marginally attached workers **had declined**."

- Slack, slack, slack

“**Readings on a range of price measures** … appeared to provide evidence that inflation had moved up recently from low levels earlier in the year,**consistent with the Committee’s forecast** of a gradual increase in inflation over the medium term.”

- Key is the word ‘consistent so nothing to worry about.
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Exit strategy comments”

“It was generally agreed that an ON RRP facility with an interest rate set below the IOER rate could play a useful supporting role…”

“… many participants judging that a relatively wide spread— perhaps near or above the current level of 20 basis points—would support trading in the federal funds market and provide adequate control over market interest rates.”

“**Most participants expressed concerns that in times of financial stress, the facility’s counterparties could shift investments** toward the facility and away from financial and nonfinancial corporations,”

“Many participants agreed that ending reinvestments at or after the time of liftoff would be best, with **most of these participants preferring to end them after liftoff**. **These participants thought that an earlier change to the reinvestment policy would involve risks to the economic outlook** if it was seen as suggesting that the Committee was likely to tighten policy more rapidly than currently anticipated”

“… a number of participants thought that it might be best to follow a graduated approach with respect to winding down reinvestments..”

- When they normalize they will do so gradually. Not likely to tighten policy rates and reduce balance sheet simultaneously, at least initially. Larger spread between ON RRP and IOER will give Open Market desk a lot to worry about. They are still discussing these exit arrangements very gingerly.

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