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The Only Two Words That Will Matter At The Fed

By Greg Robb
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(Washington) When the Federal Reserve concludes a two-day meeting next week, traders will focus on two words in its policy statement.

Since March, the Fed has promised that it intends to hold rates steady for a "considerable time" after it stops buying bonds, now on track to end in October.

Specifically, the Fed said: "The Committee continues to anticipate, based on its assessment of these factors, that it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2% longer-run goal, and provided that longer-term inflation expectations remain well anchored."

Fed watchers think it is a close call on whether this language gets dropped from the policy statement next week.

Atlanta Fed President Dennis Lockhart, in an interview with MarketWatch last month, said the central bank can wait "some meetings" before changing that language.

But other members of the committee, including some hawks and doves, want to re-write the language. Philadelphia Fed President Charles Plosser dissented from the July statement after his calls for new wording were rejected.

For the markets,the two words are important because they are seen as code for when the Fed will hike rates — in June 2015 which is the consensus call, or earlier, in March. The Fed has kept rates close to zero since December 2008.

Bernard Baumohl, chief global economist at The Economic Outlook Group, thinks the Fed will scrap the "considerable time" phrase next week on the way to the first rate hike in March.

"We expect the Fed will begin to set the stage next week by signalling that its zero-bound interest rates policy will soon be history," **Baumohl** said.

Michael Hanson, chief economist at Bank of America Merrill Lynch, said his "base case" is that the U.S. central bank does not change the language, but added it was "a pretty close call."

Markets would the Fed knows dropping the language would be taken as a signal of a possible earlier rate hike, he noted.

"I don't think they want to signal a change in policy," Hanson said.

Zach Pandl, a strategist with Columbia Management, said there was a "significant risk" the Fed does away with the considerable time language.

If they keep the wording, it "shuts the door" on a March rate hike, he said.

"By dropping the language, the Fed is leaving the option open [for a March move] but it is not making any guarantee," he added.

One reason that the language might survive is that finding compromise language to replace it could be tricky, said James Glassman, economist at J.P. Morgan Chase.

"It is very hard to figure out language that both sides would agree on," he said.

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