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Economic Update

THOUGHTS FROM OUR ECONOMICS TEAM

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# "CONSIDERABLE TIME" RECONSIDERED

Financial markets hang on two words as we approach next week's Federal Open Market Committee (FOMC) meeting: "**considerable time.**"

Since December 2012, FOMC policy statements featured the phrase 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." As the end of the asset purchase program nears (slated for October), the market naturally ponders the central bank's next move. We think it's appropriate for the FOMC to ditch the phrase, but we do not think that doing so heralds a material shift in the timing of interest rate changes--though global financial markets are hypersensitive to even minor changes.

Indeed, at her inaugural press conference in March, Chairwoman Janet Yellen learned just how sensitive the market is to the two words. When asked about the time expected to elapse during a "considerable time," Ms. Yellen stammered, "this is the kind of term—it's hard to define…it probably means something on the order of around six months or that type of thing. But, you know, it depends." Ten-year Treasury note yields rose 10 basis points on the day as the market did the math. If six months equals "considerable time" and if quantitative easing (QE) ends in early October, then the first rate hike comes in March 2015.

The March episode highlights a key problem with the "considerable time" phrase: it's a calendar-based signaling tool that the FOMC allegedly wants to avoid as a data-dependent central bank. It seems, then, that a change in language is due. It also makes sense to make the change next week as QE is slated to end in October anyway, and the October FOMC meeting will not feature a press conference in which the Fed Chair could explain the decision in more detail than provided in the 900-word FOMC statement.

Yet simply removing the "considerable time" language doesn't mean that the future is more clear or that a rate hike is more imminent. Instead, the FOMC will likely take the opportunity to change the statement language to emphasize that the fed funds rate will rise once their economic targets have been achieved. While growth rebounded in Q2, the full-year 2014 rate of economic growth is still tracking to be lackluster once more. Slack in the labor market looms large. Inflation, contrary to the squawks of the hawks, has not been a problem for years. If growth and inflation continue to disappoint the removal of two words from the statement won't etch a policy shift in stone.

But, even a seemingly minor language change matters for financial markets. While we think that QE and forward guidance policies were for the real economy (i.e., job growth) as homeopathic remedies are to an ailing medical patient, for financial markets the statement language provided a form of comfort. Central bank-provided comfort coaxed investors along in their investment allocations, and, in turn reduced volatility and put a lid on interest rates. Now, as the end of QE nears and language changes seem justified, this is a recipe for renewed volatility in asset markets. The risk: neither investors nor central bankers learned from the "Taper Tantrum" episode of 2013 what central banks were really providing global financial markets.