Continued caution: Federal Reserve maintains guidance that rates won't increase for a "considerable time"

This week, the Federal Reserve (Fed) held its two-day policy meeting and then issued its latest statement and much-anticipated specifics on its plans to draw its Quantitative Easing (QE) program to a close and normalise monetary policy. As expected, the Fed left interest rates unchanged and conditionally pledged to reduce its QE asset purchases by US$15 billion to end the program next month. Manulife Asset Management Economist Oscar Gonzalez shares his reaction to the Fed's latest statement and normalisation plans.

This week's Federal Reserve (Fed) policy statement and supporting comments by Chair Janet Yellen were in large part exercises in repetition, reiterating many of the familiar themes we heard in Yellen's Congressional testimony in July.

Interest rates remain unchanged, no new red flags were raised and the Fed's outlook is largely the same: economic activity is expanding at a moderate pace but isn't stellar; inflation is still running below the longer-run target, though it has "firmed some" since earlier this year and the likelihood of it running persistently below 2% has diminished; and there continues to be significant underutilisation of labour resources despite labour market conditions making some improvements in recent months. Yellen described a "meaningful cyclical shortfall" in labour force participation, which means the relationship between the participation rate and unemployment rate will be important to watch in the coming months.

Much of the Fed's rhetoric also stayed consistent. The phrase "considerable time" was used again to describe the window between the end of QE and its first rate hike. Yellen stressed that there is no mechanical interpretation of what "considerable time" means and that it is not calendar-based guidance.

While most Federal Open Market Committee (FOMC) members expect rates to move closer to the normal long-run level by the end of 2017, Yellen stressed – yet again – that the path of the Fed Funds rate will be wholly contingent on existing economic conditions. When pressed by journalists on timing, Yellen refused to budge and offered no promises. Whether they like it or not, "markets need to understand there's uncertainty about it," she said.

We did see more FOMC member consensus forming about rate projections for 2015, indicating that rates will very likely go up next year and maybe at a faster pace than anticipated earlier this year. (The median rate projection for the end of 2015 was 1.375% versus 1.125% in June.)

While not much else has changed since the last Fed statement in June, the Fed did offer important evidence that it is getting ready to change and has a road map prepared. This week's statement included the Fed's much-anticipated plan to normalise monetary policy after a very long period of extraordinary accommodation.

To begin normalisation, the Fed expects to wrap up the QE asset-purchasing program next month. It will then plan to raise the target Fed Funds range by adjusting the interest rate it pays on excess reserve balances, also using the overnight reverse repurchase facility "to the extent necessary." The Fed also began to detail its eventual balance sheet reduction — a process that Yellen said could take until the end of the decade.

Overall, the Fed is keeping its options open and underscoring the importance of flexibility. This includes continuing to establish a target Fed Funds range – instead of a single point – once it raises rates and normalisation begins. Yellen is staying disciplined with her messaging. Without making false promises she is providing enough detail on a future exit strategy to keep markets happy and focused on macroeconomic activity. Let's see where the data stands at the end of October.

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