Data Release: June hike unlikely as minutes reveal increased uncertainty among FOMC

- The minutes of the Federal Open Market Committee's (FOMC) April meeting acknowledged that activity had slowed during the winter months, in part reflecting temporary factors. Most participants expected that following the slowdown in the first quarter, real economic activity would resume expansion at a moderate pace, and that labor market conditions would improve further. That being said, participants noted that that recent domestic economic developments had increased their uncertainty regarding the economic outlook.

- In terms of the factors contributing to temporarily weaker growth in the first quarter, the often mentioned harsh winter weather, West Coast port disruptions, and seasonality issues in first quarter GDP were cited. More persistent factors quoted as reasons why the weakness in growth may persist included weaker-than-expected momentum in consumer spending, a lengthier slump in energy-related capital spending, and an elevated value of the U.S. dollar. That being said, most participants continued to view the risks to the outlook for economic growth and the labor market as nearly balanced.

- Participants noted that the pace of labor market improvement had slowed. However, some more positive news on labor market conditions was noted in terms of a further increase in job openings and larger wage gains reported in some areas of the country.

- While inflation continued to run below the committee's long-run objective, some participants noted that by some measures, monthly inflation readings had firmed a bit. Market-based measures of inflation compensation had risen slightly but remained low.

- In the discussion on financial market developments, some policymakers highlighted possible risks related to the low level of term premiums. In particular, "participants noted the possibility that, at the time when the Committee decides to begin policy firming, term premiums could rise sharply—in a manner similar to the increase observed in the spring and summer of 2013—which might drive longer-term interest rates higher ".

- In terms of the timing of a first lift-off in rates, a few participants anticipated that by June, sufficient information will have been received to begin normalizing policy. In contrast, many participants thought it unlikely that enough information will have been received by then to warrant a rise in rates.

- The minutes included a discussion about whether FOMC statements prior to a first rate hike should provide an explicit indication that the fed funds rate would likely be raised in the near-term. However, most participants continued to judge that the appropriate timing for a first rate hike should be determined on a meeting-by-meeting basis.

- A few participants noted that as their current estimate of the equilibrium fed funds rate was quite low relative to historical standards the FOMC may not be currently providing sufficient accommodation and counselled against any near-term policy firming. Others cast doubt on this notion. One participant suggested that because the equilibrium real interest rate was low by historical standards, perhaps the committee should discuss raising its longer-run inflation objective. While a few participants thought this discussion was useful, they emphasized that such a decision should not be taken lightly.

Key Implications

- Clearly, uncertainty regarding the economic outlook has increased among FOMC members. This uncertainty is likely to have only risen since the meeting as, aside from payrolls and housing starts, data
since the late-April meeting round has generally disappointed. As a result, it is unlikely that FOMC members bias has turned overly hawkish since then.

- While the low level of the term premium was viewed as a concern at the time of the meeting, it is unlikely to be as much of an issue at the next meeting, given recent developments. By some measures, the term premium has rebounded by 25-35bp since then, reducing the extent to which a future lift-off could cause a disorderly rise in rates and likely diminishing potential risks in the eyes of the FOMC.

- A June rate hike is almost definitely off the table. A September rate hike appears to be currently up for debate. Nonetheless, progress towards the committee's dual objectives continues to be made. Therefore, the larger issue at the moment appears to be the uncertainty concerning the economic outlook going forward. We expect that over the next several months, firming data will provide enough evidence for the FOMC, which would prefer to raise rates this year, to do so by September.

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