February 1, 2017

TD Economics

Commentary: Fed likely to stay in wait and see mode, as fiscal and trade policies begin to take shape

- As widely expected, the Federal Open Market Committee (FOMC) left the target range for the federal funds rate unchanged at between 1/2 and 3/4 percent.

- The Committee was fairly upbeat on the economy indicating that activity "continued to expand at a moderate pace", job gains "remained solid" and unemployment stayed "near its recent low."

- The statement highlighted consumer spending as "continuing to rise" but also reiterated that business investment "remained soft." However, it also added that measures of consumer and business investment sentiment have "improved of late" suggesting a potentially brighter outlook, particularly for the latter.

- Inflation was viewed as still being low but having "increased" recently. Moreover, the Committee views that it will rise to the 2 percent target over the medium term, at the same time removing the justification that this will happen as "earlier declines in energy prices and non-energy imports" dissipate. Market based measures of inflation expectations were viewed as low, a somewhat less-upbeat assessment than in December, when they were believed to be low but having "moved up considerably."

- Aside for the change in the voting membership - which became less hawkish as Bullard (St. Louis), George (K.C.), Mester (Cleveland), and Rosengren (Boston) gave up their votes to Evans (Chicago), Harker (Philly), Kaplan (Dallas), and Kashkari (Minneapolis) - not much has changed in the statement. The vote to keep rates unchanged was unanimous.

Key Implications

- As expected, this was largely a status-quo statement that highlighted some of the improvement in economic data as of late with the outlook across the FOMC appearing to be relatively constructive. Notably, the statement failed to highlight any potential risks (both upside and downside) that the U.S. economic currently faces.

- Interestingly, the Fed's take on inflation appears to have been somewhat more hawkish, with reaching the target now seen as more related to the labor market healing rather than dissipation of drag from energy declines and dollar rally. Having said that, the Fed still appears concerned about the low levels of inflation expectations priced into the markets.

- At this point we expect the Fed to remain on the sidelines over the next couple of meetings, waiting to see how the U.S. economy performs amidst the heightened uncertainty related to fiscal and trade policies in particular. Having said that, should economic activity continue to progress at a moderate pace, as is our baseline scenario, we do expect the Fed to hike before the mid-year mark and once again in the second half of this year so as to not fall behind the curve – something that's been highlighted by Chair Yellen and many other FOMC members.

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