June 15, 2016

TD Economics

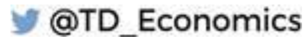
Data Release: Federal Reserve leaves rates on hold, lowers its expectation for future rate hikes

- As expected, the Federal Open Market Committee (FOMC) maintained the federal funds target range of ¼ percent to ½ percent. The Committee also maintained its policy of reinvestment of maturing assets.
- The main changes to the statement were in reference to the labor market where "the pace of improvement" was deemed to have slowed, even as "economic activity appears to have picked up." Little surprise given May's weak job report, the reference to "strong job gains" was removed.
- The statement's discussion of inflation expectations turned more cautious, noting that "market-based measures of inflation compensation *declined"* (emphasis added) rather than "remain low". The statement added a modifying "*most"* in reference to survey-based measures, implicitly acknowledging the recent downward movement in the Michigan indicator.
- The decision was unanimous, with the lone dissenter last meeting, Kansas City Fed President, Esther George, joining the rest of the FOMC in favor of leaving rates on hold.
- The summary of economic projections (SEP) released with the statement downgraded slightly the projections for economic growth, with a median estimate of 2.0% for all years in the forecast horizon. Projections for core PCE inflation edged up 0.1 percentage points in 2016 and 2017, but where otherwise unchanged.
- After falling from four expected rate hikes to two at the last SEP in March, the median "dot" projection of FOMC members for the end of 2016 was unchanged at 0.9%, suggesting that most Fed members still anticipate two rate hikes over the course of this year. While the median was unchanged, the dots did show some downward migration, with only two dots above the median estimate (down from seven in March). The median dot moved down 25 basis points for 2017 and over 50 basis points for 2018. Even the long term dot came down 25 basis points to just 3.0% - in line with our projections of the neutral rate. Notably, one FOMC member is projecting no change in the policy rate through 2018.

Key Implications

- The theme of lower for longer came through loud and clear in this statement, but even more so in the updated projections. The downward migration in Fed dots is particularly notable, especially in 2017 and 2018. Even the hawks on the Committee appear to be tempering their views as evidenced by the greater migration from the top end of the projections.
- Slowly but surely, the Fed appears to be recognizing the danger of low and falling inflation expectations. Even as the data points to inflation firming, this has done little to move up market-based inflation measures. The most recent downward thrust is related to uncertainty surrounding the UK vote next week, and they should move higher once this uncertainty dissipates. The fact that the Fed is responding to it, both in their statement and in their projections for rate hikes should help keep expectations from becoming unmoored to the downside.
- The good news is that the American economy continues to make progress. Led by consumer spending, growth in the second quarter is running above 2.5%. This should show up in a rebound in job growth in the months ahead, which should provide the impetus for the Fed to raise rates at least once in the second half of this year.

James Marple, Senior Economist
416-982-2557



DISCLAIMER
This report is provided by TD Economics. It is for informational and educational purposes only as of the date of writing, and may not be appropriate for other purposes. The views and opinions expressed may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice. The report does not provide material information about the business and affairs of TD Bank Group and the members of TD Economics are not spokespersons for TD Bank Group with respect to its business and affairs. The information contained in this report has been drawn from sources believed to be reliable, but is not guaranteed to be accurate or complete. This report contains economic analysis and views, including about future economic and financial markets performance. These are based on certain assumptions and other factors, and are subject to inherent risks and uncertainties. The actual outcome may be materially different. The Toronto-Dominion Bank and its affiliates and related entities that comprise the TD Bank Group are not liable for any errors or omissions in the information, analysis or views contained in this report, or for any loss or damage suffered.