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# TD Economics

**Data Release: FOMC slaps the June hike squarely back on the table**

- In their April statement, the FOMC indicated that economic activity *appears* to have slowed in the first quarter. The minutes further indicated that officials are largely seeing through this weakness, citing measurement and transitory factors. Still most saw the outlook as constructive with a pick-up in the rest of the year driven by robust consumer spending. This belief was based on the solid fundamentals including: ongoing robust gains in employment, low energy prices, high household wealth, and high consumer confidence. The Committee's confidence in the transitory nature of the weakness was further shored up by the view that the slowdown was only in goods purchases as well as "generally positive" reports from the Federal Reserve Banks' Beige Books.

- The Fed also removed from the April statement the reference to downside risk stemming from "global economic and financial developments." The improvement of global financial conditions was viewed as being related to the Fed's shifting-down of rate path, dollar depreciation and better economic indicators out of advanced and emerging economies, including China. Moreover, the Committee appeared elated that U.S. firms and markets looked very resilient despite the global upheaval. Brexit was not mentioned in the minutes at all, which instead highlighted financial stability risks related to CRE prices, mutual fund illiquidity, and Puerto Rican debt.

- To that end, the FOMC was presented briefings on the relationship between monetary policy and financial stability. During discussions, most participants viewed that monetary policy was not the optimal way to deal with threats to financial stability given uncertainty and potential risks of deviating from the Fed's to main objectives of full-employment and price-stability. Still, this was not ruled out and could be used if macroprudential tools were ineffective and the developments were seen as potentially threatening to achieving the dual mandate.

- Many officials noted that labor market conditions are already at or near maximum-employment with several reporting wage acceleration and worker shortages in their Districts. Still, many others saw further scope to reduce slack in the labor market, noting the recent rise in the number of people rejoining the labor force as a welcome development. Along with part-time to full-time conversions, they saw an opportunity for the economy to expand further without creating too much additional inflation.

- Several FOMC members remained concerned about the continued low levels of inflation compensation and decline in some measures of expected inflation. Still, many others were increasingly confident that inflation would rise to the target over the medium term given the broad firming in core inflation and increases in alternative measures of trend inflation. Additionally, tightening of resource utilization, dollar depreciation, and a recovery in oil prices all suggest that their downward pressure on inflation should begin to subside.

- In light of the continued divergence between strong hiring and modest economic growth the Fed took up a topic of low productivity. Some members suggested that even with slow GDP growth, if productivity growth remains weak then "the unemployment rate might decline more quickly and inflation might rise a bit more rapidly than expected" suggesting a need for faster removal of monetary accommodation.

- A few participants already felt it was appropriate in April to raise rates given the improvement in global economic and financial conditions and a labor market near full-employment. Even more felt that they would be comfortable with raising in June should economic data prove supportive. Some noted risks related to waiting too long in light of monetary policy lags as well as credibility issues with deviations from typical monetary policy rules were also used as arguments for why it is better to raise earlier but at a slower pace.

**Key Implications**

- The Committee viewed the recent slowdown in Q1 as temporary and downside risks to financial markets as reduced. Given the expectation of continued improvement in labor markets, a somewhat weaker dollar, and oil prices bottoming, the Committee appears increasingly comfortable with the notion that inflation would move up to the target over the medium run.

- Still, the FOMC is cognizant of the reality on the ground which is one of: below-target inflation; weak, and in some cases, declining inflation expectations; and a downward tilt to inflation risks. Moreover, while global risks appear to have subsided, they warrant close monitoring given the fragility of the global recovery. As such, it is likely to proceed cautiously with any rate hikes going forward.

- Overall, the Committee appears to be getting ready to raise rates soon. The discussions in April suggest that the Fed is increasingly comfortable with a June hike. It failed to single out Brexit and pointed to expectations of constructive data between April and June as justification for action given labor market progress and lags in monetary policy. Data has come in largely better than expected so far. If it continues to support, and if global volatility does not flare up, a June hike may very well materialize. We view the odds as largely a flip-coin.

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