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TD Economics

Data Release: Still no agreement on slack, but Committee leaves door open for near-term hike

- In the first meeting of 2017, the outlooks of most Federal Open Market Committee (FOMC) participants were little changed from the December round, with most members expecting a continuation of moderate expansion in economic activity and a gradual rise in inflation to target over the medium-term.

- The FOMC largely judged the balance of risks to the outlook as even. Having said that, participants noted the "considerable uncertainty about the prospects for changes in fiscal and other government policies" both in terms of timing and the magnitude of the impact on the economy. While most viewed the potential for fiscal policy to have increased "upside risks," some noted "several potential changes in government policies" may result in downside risks. While many viewed the external downside risks as having diminished, several indicated that many risks still remain, particularly those associated with U.S. dollar appreciation, financial vulnerabilities in "some foreign countries," and the still low level of the fed funds rate.

- Some participants remained concerned that faster-than-expected economic growth and/or undershooting of the long-term unemployment rate posed upside risks to the inflation outlook, arguing that inflation metrics have begun to tick-up at the end of 2016. This view was balanced by the doves, who argued that the appreciating dollar, and still low levels of inflation compensation and expectations posed a downside to the outlook for price growth. Moreover, patience was advised by some participants arguing that the labor market still has some healing to do given that workers continue to be pulled off the sidelines, quits rates are rising, and wage compensation is still accelerating.

- Most participants expected that a "gradual" pace of rate increases was likely to be appropriate to achieve the FOMC's dual-mandate. Still, many participants opined that it may be "appropriate to raise the federal funds rate again fairly soon" as long as incoming economic information was in line or stronger than current expectations or if "risks of overshooting" the targets increased. Few participants highlighted the need to "timely" remove accommodation, "potentially at an upcoming meeting," given the risks of "overshooting," which could potentially necessitate the need to raise "more quickly than most participants currently anticipated."

- Participants felt that discussions about its "reinvestment policy" should take place at upcoming meetings, with implementation and communication of any changes being top of mind.

- Aside for that, much of the discussion during the first meeting of the year had to do with procedural matters, such as reaffirming and/or amending the statement on longer-run goals and monetary policy strategy. On this front, the only difference prior to last year's statement was the estimate of longer-run normal rate of unemployment, which was now thought to be lower at 4.8% (down from 4.9% during the January 2016 meeting round).

- The Committee also decided to add fan charts to its Summary of Economic Projections so as to highlight the potential uncertainty related to individual participants' projections and enhance its external communications mandate. Participants also suggested a need to alter its communications as far as the "anticipated path for the policy rate" or "dots" should economic outlook change.

Key Implications

- There was lots of discussion during the first meeting of 2017, with procedural matters taking up a large portion of the participant's time. On that front not much has changed, besides tweaks to communication strategy that would include fan charts and potential changes to the "dot" plots. This could be partly motivated by the FOMC becoming increasingly uncomfortable with the markets associating the "gradual" pace of rate hikes with just one or two per year. The blackout period was also extended by a few days.

- The perennial discussion about how much slack remains in the economy remained top of the discussion agenda, but the hawks appeared to have the upper hand during this meeting, with more participants appearing concerned that there is more of a potential for an overshooting on the inflation target associated with faster-than-expected economic growth. Such a scenario could necessitate a faster need for rate hikes, which could pose a greater risk to the economy than starting earlier and moving more gradually.

- Overall, the minutes suggest the Fed feels increasingly uncomfortable with being boxed into a path of rates that the markets have determined as "gradual" and will try to keep every meeting as "live" as possible. While we don't rule out a March or May hike, should the data continue coming in relatively constructive – particularly on the inflation metric front – our baseline scenario remains for a mid-year hike and another one later on in 2017.

Michael Dolega, Senior Economist
416-983-0500

@TD_Economics