FOMC LEAVES POLICY UNCHANGED BUT APPEARS MORE CONFIDENT IN OUTLOOK

As expected, the FOMC voted to leave the federal funds rate target unchanged at its January 31-February 1 meeting. There were no material changes made to the Fed's official Policy Statement. The Committee indicated more confidence in its economic outlook:

> (1) The Policy Statement included a sentence on sentiment: "Measures of consumer and business sentiment have improved of late." As we have emphasized, the sizeable improvement in sentiment indicates a likely positive response if new fiscal legislation is actually enacted (see "US sentiment surges post-election", January 9, 2017).
> (2) The Committee appears to be more confident about the trajectory of inflation. It now believes that inflation "will" rise to 2%, before it believed that inflation was "expected" to rise to 2%.

Although the FOMC still views the risks to the economic outlook as "roughly balanced", these changes suggest that the Fed now tilts toward the upside, risk for future economic performance.

Still expect the next hike to take place in June, but a March rate hike is clearly still on the table, especially if the economic data remains robust. The next quarterly Summary of Economic Projections will be released at the March meeting and more FOMC members are expected to incorporate expectations of fiscal reform into their forecasts (only half of FOMC members incorporated expectations for expansionary fiscal policy in their December projections). The minutes from this week's FOMC meeting may reveal insights into the Fed's thinking about fiscal policy and how it could affect the policy rate path and balance sheet policy.

The Fed could find itself in a quagmire in the next couple of years if fiscal reform leads to an overheating economy. Because of the very (too) easy monetary policy over the last few years, the Fed might be behind the curve. Moreover, the Fed's reaction function might change markedly with the addition of new members to fill vacancies on the Board and the replacement of Yellen once her term ends in February 2018. Monetary policy remains a key wildcard in the economic and inflation outlook.

Next: Chair Yellen will deliver her semi-annual congressional testimony to the Senate Banking Committee on February 14th and the House Financial Services Committee on February 15th.

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