

## MAY FOMC ON HOLD

The FOMC voted to keep the Federal funds rate unchanged at 0.75-1% at its May meeting and to maintain its current policy of reinvesting maturing assets in its portfolio. There were no dissents.

The Fed is likely to raise rates at its June and September meetings, before announcing a change in its balance sheet policy late in the year. **The Fed's reaction function has** changed significantly from the last two years as it appears to be firmly on a policy normalization track and is not reacting to every piece of high frequency economic **data. It would take a dramatic slowdown in the economy to derail the Fed's** normalization plans.

The Fed has made significant progress on its dual mandate, with the unemployment rate at 4.5%, and the PCE deflator growing near 2% yr/yr. The Fed now fears falling behind the curve. Its preferred measure of wage inflation, the Employment Cost Index, grew at its fastest pace in this recovery (+0.8% q/q) in Q1, suggesting that the long-awaited pick up in wage growth may be near, and business surveys point to building price pressures.

The Fed downgraded its assessment of economic activity in its statement, and indicated that it “views the slowing in growth during the first quarter as likely to be transitory” (We share a similar view, see [“US GDP: Q1 quirky, expect rebound”](#), April 28, 2017). It downgraded its characterization of core inflation (excludes food and energy) after the decline in March, which was also exacerbated by temporary factors (see [“Soft US CPI partly due to anomalous factors and core retail sales strong”](#), April 14, 2017). There are several economic reports released before the June 13-14<sup>th</sup> FOMC meeting that the Committee will use to determine if broader trends in economic activity and inflation are turning up (see list below).

Expect the Committee to reveal more details about the impending change in its balance sheet policy in the minutes to its May meeting on May 24<sup>th</sup>.

Key Economic Data before the June FOMC meeting

*Nonfarm Payrolls (April) – May 5*

*CPI (April) – May 12*

*Retail Sales (April) – May 12*

*Industrial Production (April) – May 16*

*Durable Goods Orders and Shipments (April) – May 26*

*Personal Consumption and PCE Deflator (April) – May 30*

*Nonfarm Payrolls (May) – June 2*

*CPI (May) – June 14*

*Retail Sales (May) – June 14*

04 May 2017

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