FED MINUTES HIGHLIGHT ECONOMIC MOMENTUM AND TRADE RISKS; RATE HIKE LIKELY SOON

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The minutes to the July 31-August 1 FOMC meeting reaffirmed the Fed's confidence in current economic and inflation conditions and the outlook, and essentially cemented a September policy rate hike with many participants suggesting that "it would likely soon be appropriate to take another step in removing policy accommodation" if conditions evolve as expected.

Participants echoed the more optimistic characterization of the U.S. economy reflected in the August 1 Official Post-Meeting Policy Statement with some citing "stronger underlying momentum in the economy [as] an upside risk", but intensified global trade tensions as a "potential consequential downside risk for real activity." Other potential downside risks mentioned were a U.S. housing market slump, a jump in oil prices, and a slowdown in emerging market economies.

Many participants expect sustained inflation near 2% in the medium term, but there were other views surrounding inflation risks: 1) some participants doubted whether inflation would stay near 2%, given that it has undershot the target for most of the last six and a half years, and preferred to see more evidence of underlying inflation and inflation expectations moving to levels consistent with its 2% target; 2) others expressed concern about heightened inflationary pressures, if the economy grew above potential for a prolonged time, that would lead to an economic downturn. Several participants noted that tariffs could put short-term upward pressure on inflation, suggesting that they would likely look through such a temporary boost.

We expect the Fed to increase the Federal funds rate at its September and December meetings, and its discussions indicate that it continues to move along with a gradual pace of rate hikes. **Participants discussed the need to revise the language in its Policy Statement that "the stance for monetary policy remains accommodative" given that the Federal funds rate is likely to move about the Committee's projected appropriate longer-run rate as early as next year.** The median Fed member, currently forecasts that the appropriate policy rates at the end of 2019 and 2020 will be 3.1% and 3.4%, respectively, above the median 2.9% long-run projection.

There was no explicit mention about its estimates of potential real GDP growth, but the minutes mentioned the uncertainties in estimates of the neutral rate of interest a couple of times, suggesting that some participants are open to changing their estimates based on economic developments. Note that Fed participants have not materially changed long-run real GDP forecasts since the Tax Cuts and Jobs Act, but if its impact turns out to be more long-lasting as we expect, they will likely upgrade long-run estimates in coming quarters. **A few participants mentioned the possibility of some labor market slack given rising labor force participation rates among certain groups that are offsetting to the downward pressures from the retiring baby boomer group. Sustained increases in labor force participation for the prime working-age cohort and stronger-than-expected labor force growth would lead to higher long-run GDP growth estimates.**

The minutes again included discussions about the yield curve and its implications for the economy. Participants had mixed views: **1) Some thought it was important to pay close attention to the yield curve given that inverted yield curves had preceded prior economic downturns; 2) Others noted that the yield curve was flattening because global factors were holding down term premiums, so it is not necessarily indicative of a pessimistic domestic economic outlook, and that other economic and financial indicators should also be considered.**

A couple of participants commented on the operating framework of the implementation of monetary policy, including implications for the size and composition of the Fed's balance sheet. They plan to resume discussions on these issues in the fall.

The September 25-26 meeting will include the quarterly Summary of Economic Projections that will extend forecasts to 2021 for the first time. The Committee is likely to upgrade its near-term real GDP forecast - following the robust 3.1% H1 growth, H2 growth would have to decelerate to 2.5% in order for its 2.8% Q4/Q4 forecast to be realized - the median number of 2018 rate hikes should remain at four, with more participants expecting four rather than three total rate hikes. Fed participants may lower their estimates of the natural rate of unemployment, currently 4.5%, given that the unemployment rate has been below it for so long and accompanied by only moderate wage growth.

Fed Chairman Powell will speak at the Kansas City Fed's annual policy symposium in Jackson Hole on "Monetary Policy in a Changing Economy" on Friday, August 24th. We do not expect him to focus on the Fed's intentions for the September meeting, but rather, key longer-run policy issues.

IMPRESSUM

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