

US: RECAP OF JANUARY-FEBRUARY FOMC MINUTES

The minutes of the January 31st/February 1st FOMC meeting suggested, as Chair Yellen indicated last week, that Fed members will consider a rate increase in upcoming meetings:

“In discussing the outlook for monetary policy over the period ahead, many participants expressed the view that it might be appropriate to raise the federal funds rate again fairly soon if incoming information on the labor market and inflation was in line with or stronger than their current expectations or if the risks of overshooting the Committee’s maximum-employment and inflation objectives increased.”

In response to the slew of strong economic data and the pickup in consumer price inflation, we moved forward our expectation for the next rate hike to March from June (see [“March Fed rate hike seems most likely”](#), February 17, 2017). The March FOMC meeting is just three weeks away, but key upcoming data releases on inflation and **wages could influence the FOMC’s decision**: the PCE deflator, the Fed’s preferred measure of inflation, likely rose significantly in January, reflecting the 0.6% m/m rise in the CPI, lifting its yr/yr rise close to the Fed’s 2% target; and February’s Employment Report is expected to show a bounceback in the yr/yr rise in average hourly earnings from its January dip (getting a lift from the flat February 2016 base).

Under the current economic circumstances and strong confidence (which the Fed cited in its official Policy Statement following its last meeting), delaying a March rate **hike would conflict with the Fed’s “data-dependent” policy and damage its credibility.**

Financial futures markets put less than a 50-50 chance on the Fed raising rates in March (the implied probability is now 34%). That’s understandable: the Fed uses its data-dependence framework to mean whatever it wants...to be totally discretionary.

According to the minutes, **“A few participants noted that continuing to remove policy accommodation in a timely manner, potentially at an upcoming meeting, would allow the Committee greater flexibility in responding to subsequent changes in economic conditions.”** We have made this point consistently: a rate hike in March would provide the Fed more flexibility to raise rates three times in 2017, consistent with the **FOMC’s median forecasts in December.**

FOMC participants view the possibility of fiscal reform as increasing the upside risks to the economic outlook, but some also thought certain policies provide downside risks. The Committee has not yet incorporated any assumptions about fiscal policy. If pro-growth fiscal reforms are enacted, the Fed will be placed in an awkward situation: it will need to revise up its economic forecasts, but it will be constrained by its 2% inflation target from revising up its inflation forecast.

From the current situation of a strikingly accommodative monetary policy, the Fed having virtually achieved its dual mandate, momentum in the economy, and the prospects of fiscal reforms, the Fed would be prudent to raise rates in March. If Yellen’s devout dovishness leads the Fed to remain on hold, a couple of FOMC members may dissent, as several members including Harker, Kaplan, and Powell have not ruled out the possibility of a near-term hike.

22 February 2017

Economics

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*Note that the Fed will introduce a new innovation to its Summary of Economic Projections at its March meeting – fan charts indicating uncertainties that **surround the FOMC members’ economic forecasts**. In light of the uncertainties and difficulties in forecasting, we believe this is a positive step forward in transparency.*

Key Events before March meeting:

March 1: January PCE Deflator

March 3: Speeches by Fed Chair Yellen and Fed Vice Chair Fischer

March 10: February Employment Report

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