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Six Takeaways From The FOMC Minutes

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- There are six broad takeaways that can be drawn from the FOMC minutes (here). On balance, the USD and Treasury yields are unaffected post-release while equities have softened somewhat.
- First, **a September Fed hike is even more of a slam dunk**. Key is the following passage that reintroduced 'soon':

  > "Many participants suggested that if incoming data continued to support their current economic outlook, it would likely soon be appropriate to take another step in removing policy accommodation."

- Second, **there is no indication that they are altering their assessment of the balance of risks in such fashion as to cast doubt upon continuing to hike at a gradual pace after hiking in September.** That still leaves the door open to a fourth hike later in the year and provides no material information to further inform risks to Scotia's forecast for two more hikes this year and two more next year ending 2019 at a Fed funds target rate of 3%. There are two key passages in this regard:

  > "Participants generally viewed the risks to the economic outlook as roughly balanced."
  >
  > "Participants generally expected that further gradual increases in the target range for the federal funds rate would be consistent with a sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. Many participants reiterated that the actual path for the federal funds rate would ultimately depend on the incoming data and on how those data affect the economic outlook."

- Third, having said that they are not as yet altering the balance of risks, **we finally have a more direct, concrete reference to potential downside risks emanating from trade policy**. One could quip 'what took them so long!' but it's a signal they have rising concerns. The key passage is below, but again, I'd emphasize that they are not yet convinced that it is enough to move the needle on the balance of risks in the overall mixture of upside and downside risks that they discuss. Monitoring is the name of the game, versus re-writing the playbook in the context of what are so far small effects.

  > "In addition, all participants pointed to ongoing trade disagreements and proposed trade measures as an important source of un-certainty and risks. Participants observed that if a large-scale and prolonged dispute over trade policies developed, there would likely be adverse effects on business sentiment, investment spending, and employment. Moreover, wide-ranging tariff increases would also reduce the purchasing power of U.S. households. Further negative effects in such a scenario could include reductions in productivity and disruptions of supply chains."

- Fourth, while they say they are closer to neutral, it is important to note a) **that they don't have any greater conviction regarding exactly where such a neutral point sits, and b) it's a truism to say we are closer to neutral** (e.g. compared to, say, 100bps ago…) and they've previously indicated that neutral is getting nearer anyway. The relevant passage is as follows:

  > "Participants noted that the federal funds rate was moving closer to the range of estimates of its neutral level."

> "A number of participants emphasized the considerable uncertainty in estimates of the neutral rate of interest, stemming from sources such as fiscal policy and large-scale asset purchase programs. Against this background, continuing to provide an explicit assessment of the federal funds rate relative to its neutral level could convey a false sense of precision."

- Fifth, **expect a deeper dive into the discussion on balance sheet management practices at any one of the three remaining meetings this year given the "in the Fall" reference with Fall sandwiched between the arrival of the autumnal equinox on September 22nd and the winter solstice on December 21**. Given that Fall covers every one of the three remaining meetings this year, they could have been more specific on the timing of the discussion. The relevant passage is here:

> "These participants judged that it would be important for the Committee to resume its discussion of operating frameworks before too long. The Chairman suggested that the Committee would likely resume a discussion of operating frameworks in the fall. "

- Sixth, **the Fed is so far not signalling any incremental concern about broad dollar strength and implications by way of pass-through effects to inflation, trade and output.** If dollar strength since February persists, then this bias may become challenged later in the year.

> "Participants remarked on the extent to which financial conditions remained supportive of economic expansion. Over the intermeeting period, only a small change in overall financial conditions occurred, with modest movements on net in equity prices and in the foreign exchange value of the dollar."

- The next Fed communications will emphasize tomorrow's night's Jackson Hole agenda (8pmET) and then Chair Powell's address at 10amET on Friday.
- Below please find the usual categorization of the opinions of FOMC participants using the Fed's language for the frequency of citations.

All

- In addition, all participants pointed to ongoing trade disagreements and proposed trade measures as an important source of un-certainty and risks. Participants observed that if a large-scale and prolonged dispute over trade policies developed, there would likely be adverse effects on business sentiment, investment spending, and employment. Moreover, wide-ranging tariff increases would also reduce the purchasing power of U.S. households. Further negative effects in such a scenario could include reductions in productivity and disruptions of supply chains.

Generally Agreed

- Participants generally noted that economic growth in the second quarter had been strong; incoming data indicated considerable momentum in spending by households and businesses.
- For the second half of the year, participants generally expected that GDP growth would likely slow from its second-quarter rate but would still exceed that of potential output.
- Participants generally viewed the risks to the economic outlook as roughly balanced.
- They generally continued to see fiscal policy and the strengthening of the labor market as supportive of economic growth in the near term.
- Participants generally characterized inflation as running close to the Committee's objective of 2 percent, and most of those who expressed a view indicated that recent readings on inflation had come in close to their expectations.
- Participants generally judged that the current stance of monetary policy remained accommodative, supporting strong labor market conditions and inflation of around 2 percent.
- Participants generally expected that further gradual in-creases in the target range for the federal funds rate would be consistent with a sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term.

Nearly All

- none

Almost All

- none

All but one

- none

Majority

- none

Most

- Participants generally characterized inflation as running close to the Committee's objective of 2 percent, and most of those who expressed a view indicated that recent readings on inflation had come in close to their expectations. Consistent with their SEP submissions in June, several participants remarked that inflation, measured on a 12-month basis, was likely to move modestly above the Committee's objective for a time.
- Most ex-pressed the view that an escalation in international trade disputes was a potentially consequential downside risk for real activity.

More than half

- none

Fewer than half

- none

Several

- Several participants stressed the possibility that real GDP growth in the second quarter may have been boosted by transitory factors, including an outsized increase in U.S. exports.
- Several participants observed that the agricultural sector had been adversely affected by significant declines in crop and livestock prices over the intermeeting period.
- Several participants commented that increases in the prices of particular goods, such as those induced by the tariff increases, would likely be one source of short-term upward pressure on the in-flation rate, although offsetting influences—including the negative effects that trade developments were having on agricultural prices—were also noted.
- Several participants also pointed to the continued strength in business fixed investment, although the persistent weakness and the risk of a further slowdown in residential investment were also noted
- several participants remarked that inflation, measured on a 12-month basis, was likely to move modestly above the Committee's objective for a time.
- Several participants cited statistical evidence for the United States that inversions of the yield curve have of-ten preceded recessions. They suggested that policy-makers should pay close attention to the slope of the yield curve in assessing the economic and policy outlook. Other participants emphasized that inferring economic causality from statistical correlations was not appropriate. A number of global factors were seen as contributing to downward pressure on term premiums, including central bank asset purchase programs and the strong worldwide demand for safe assets. In such an environment, an inversion of the yield curve might not have the significance that the historical record would suggest; the signal to be taken from the yield curve needed to be considered in the context of other economic and financial indicators.

Many

- Many participants anticipated that, over the medium term, high levels of resource utilization and stable inflation expectations would keep inflation near 2 percent.

- Many participants suggested that if incoming data continued to support their current economic outlook, it would likely soon be appropriate to take another step in removing policy accommodation.
- Many participants reiterated that the actual path for the federal funds rate would ultimately depend on the incoming data and on how those data affect the economic outlook.

Some

- However, some participants expected a pickup in aggregate nominal wage growth to occur before long
- However, some participants observed that inflation in recent years had shown only a weak connection to measures of resource pressures or indicated that they would like to see further evidence that measures of underlying inflation or readings on inflation expectations were on course to attain levels consistent with sustained achievement of the Committee's symmetric 2 percent inflation objective.
- Some participants raised the concern that a prolonged period in which the economy operated be-yond potential could give rise to inflationary pressures or to financial imbalances that could eventually trigger an economic downturn.
- Some noted larger or more persistent positive effects of these factors as an upside risk to the outlook. [ed note: in reference to fiscal policy and strengthening labor market supports to growth]
- Some commented that consumer spending had been quite strong in the second quarter, confirming their impressions that the firstquarter weakness had been temporary.
- Some participants noted that stronger underlying momentum in the economy was an upside risk;
- Some participants suggested that, in the event of a major escalation in trade disputes, the com-plex nature of trade issues, including the entire range of their effects on output and inflation, presented a challenge in determining the appropriate monetary policy response.

A number

- a number of participants reporting that wage pressures in their Districts were rising or that firms now exhibited greater willingness to grant wage increases.
- A number of participants emphasized the considerable uncertainty in estimates of the neutral rate of interest, stemming from sources such as fiscal policy and large-scale asset purchase programs. Against this background, continuing to provide an explicit assessment of the federal funds rate relative to its neutral level could convey a false sense of precision.

A few

- A few participants ex-pressed increased confidence that the recent return of inflation to near the Committee's longer-term 2 percent objective would be sustained.
- Although a few participants observed that the trimmed mean measure of inflation calculated by the Federal Reserve Bank of Dal-las was still below 2 percent, a couple noted forecasts that this measure would reach 2 percent by the end of the year.
- A few participants indicated, however, that a faster-than-expected fading of the fiscal impetus or a greater-than-anticipated subsequent fiscal tightening constituted a downside risk.
- A few participants emphasized that financial stability risks could be reduced if these institutions further boosted their capital cushions while their profits are strong and the economic outlook is favorable; arguments for and against the activation of the countercyclical capital buffer as a means of further strengthening the capital positions of large banks were discussed in this context.
- A few participants suggested there could still be some labor market slack, citing recent increases in labor force participation rates relative to prevailing demo-graphically driven downward trends; the participation rate of prime-age men, in particular, was still below its previous business cycle peak. Other participants judged that labor market conditions were tight, pointing to other data, including job quits and openings rates, and anecdotes from contacts.

A couple

- However, a couple of participants reported vibrancy in industrial and multifamily construction activity.

One

- None