

US Economic Comment

Thoughts on the Fed – minutes and Williams

Economics

Americas

July FOMC minutes may start the clock on a December hike

The July FOMC meeting statement marked the return of the risk statement as the FOMC noted that "Near-term risks to the economic outlook have diminished", the first statement of risks since the FOMC noted that it "sees the risks to the outlook for both economic activity and the labor market as balanced" at the December 2015 FOMC meeting (the meeting the committee moved off of the zero bound).

We viewed the FOMC bringing the risk statement back as a sign that the FOMC is beginning to prepare markets for a rate hike later this year. A more passive interpretation would have it reflecting a simple acknowledgement that the impact the UK "leave" vote had on the US economic outlook was likely less than had been anticipated by the FOMC despite Chair Yellen having flagged that as a risk in her June post-FOMC meeting press conference.

If we are correct, it would suggest that July was the start of the clock for a year-end rate hike. We would expect Chair Yellen's Jackson Hole speech next week to reinforce that view before the September FOMC meeting and press conference, with the September statement and projections confirming that a December rate hike was the most likely scenario. Alternatively, if the reinsertion of the risk statement was only filler to acknowledge events, it would be less indicative of future action. The July FOMC meeting minutes should show which of these interpretations is more likely to be correct and, consequently, which direction the FOMC is leaning towards year end.

What is President Williams thinking?

In a recent "Economic Letter" the President of the Federal Reserve Bank of San Francisco, John Williams, argued that a higher inflation target (or nominal GDP targeting) would help to mitigate the impact of a lower "natural rate of interest". Related ideas have been simmering within the Fed for some time and, as Williams explains, he is not "advocating an abrupt reversal of course" with regard to current policy. Rather, as President Williams notes, "now is the time ...to carefully investigate the pros and cons of these proposals." Indeed, the just-published letter is consistent with the theme of the upcoming Jackson Hole conference: "Designing Resilient Monetary Policy Frameworks for the Future".

Even if President Williams was advocating an immediate shift and his arguments swayed the committee, it would be unlikely to significantly alter the near-term policy path. If we took a standard Taylor rule model for appropriate policy and both raised the inflation target and incorporated an evolving natural real rate of interest, the policy path the FOMC has laid out in their central tendency forecasts would still be shallower than the model prediction over the next few quarters (not even including any stimulative impact of an expanded Fed balance sheet).

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