Daily Economic Update

July 26, 2017

Fed stands pat as expected, signals coming balance sheet normalization

Our Take:

Expectations for this week's meeting were low and the Fed delivered on that with no rate change and a policy statement that was very similar to June's. The sole development was a change in language on balance sheet normalization though that was not a surprise. The Fed is now indicating that the planned change in their reinvestment policy, which was outlined in June, will begin "relatively soon." We think today's guidance sets up for tapering to be announced in September and implemented in October. The pace of tapering laid out by policymakers is gradual but nonetheless we think the Fed will want to see how the market reacts. As such, we look for interest rates to be held steady once again in September, breaking the recent trend of one hike per quarter. Holding off on further rate increases until later this year will also give the Fed some time to evaluate inflation developments. We think the Fed will want to see some evidence that tight economic and labour market conditions are actually feeding through to higher prices before going too far toward normalizing interest rates.

Highlights:

- The target range for the fed funds rate was left unchanged at 1.00-1.25% as expected.
- The Fed's characterization of the economy was almost entirely unchanged: growth has been moderate with household spending and business investment continuing to expand.
- The recent decline in both all items and core inflation was noted and inflation is expected to continue running below 2 percent in the near term. Chair Yellen has previously attributed some of the slowing to transitory factors.
- Near-term risks to the outlook were again characterized as "roughly balanced."

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