TD Economics

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Data Release: QE to end in October, but reinvestment may continue until rate lift-off (or beyond)

- Minutes of the June 17-18th FOMC meeting outlined broad consensus in a strengthening recovery in Q2 and a belief in further acceleration over the next two-and-a-half years that will be sufficient to bring the unemployment rate close to its long-run level. This level is currently judged to be about 5.2% to 5.5% range according to the median of the Summary of Economic Projections (SEP).
- General labor market improvement was agreed upon, but the amount of slack remains a source of disagreement within the Committee, with some members viewing the decline in the jobless rate as overstating the health of the labor market. In contrast, some other members pointed to further improvement in long- and short-term unemployment, as well as gains in other measures, like the marginally employed.
- Alluding to additional analytical measures of price pressures developed by FRBs (in addition to PCE deflator and CPI), the Committee feels that inflation has moved up recently, in line with their forecasts and will continue to trend toward their 2% objective (as measured by PCE deflator) over the forecast horizon.
- The Committee remains aware that wage gains have so far been only modest, with strength in consumer spending substantially supported by household wealth gains. Nonetheless, the FOMC feels that income gains will materialize as further progress in employment creation spurs wage growth. In particular, a pick-up in real wage growth in line with productivity would provide the needed support for continued gains in household spending.
- Housing also remains on the Committee's radar, with discussions surrounding whether the current weakness in housing is a temporary delay in the recovery or a persistently lower level of homebuilding. Restrictive credit conditions and low demand from young homebuyers (often saddled with student debt) were offered as explanations for dampened demand, with supply side factors also raised. Structural changes stemming from demographics were raised as a potential reason for higher demand for multi-family units.
- Business conditions were seen as broadly improving, with credit, investment and hiring intentions looking more favorable than before.
- Participants generally agreed that QE would come to an end at the end of the year, with purchases coming to a halt in November, after a $15bn addition to SOMA in October. However, the $15bn vs. $5bn final cut was seen as a technicality and of little significance for monetary policy.

Key Implications

- The minutes revealed a Committee relatively unconcerned about the recessionary first quarter reading, with the narrative regarding future strengthening in growth largely unchanged.
- The FOMC remains acutely aware of the two weak links in the economy: slowdown in housing and subdued wage growth. These will continue to be monitored and without further improvement, could sway the Committee into a more dovish frame of mind going forward.
- The Committee is also aware that inflation has turned the corner. Arguably, the turnaround happened quicker than the Fed (and most economists) expected. Nonetheless, the Fed remains unconcerned so long as wage pressures remain subdued.
- As the Fed begins to contemplate potential lift-off in rates next year, more of its resources have been directed towards making sure this goes smoothly. As such, analysis of the three main tools that should enable the Fed to control short-term rates alongside a large balance sheet has ramped up. These tools include: interest on excess reserves, fixed-rate full-allotment overnight reverse repo,

and term deposit facility, with discussion surrounding their implementation taking center stage. With the Fed slated to be done with QE in October (aside from reinvestments), we expect to hear more details on this in the near future.

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