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TD Economics

Data Release: Minutes from the landmark December meeting paint a picture of broadening consensus

- The minutes from the Federal Open Market Committee's December 15-16 2015 meeting round suggested almost all participants believed that "improvements … in the labor market and their confidence in a return of inflation to 2 percent over the medium term" were sufficient for lift-off from ZIRP.

- Policy normalization was expected to be gradual so as to be "sufficiently accommodative" for further labor market improvement and upward pressure on inflation. Other reasons for a "gradual" pace of hikes was the normal delay in data releases as well as time to assess how economic growth is responding to higher rates. Other reasons included the notion that the neutral real interest rate is only estimated to be close to zero and likely to rebalance to its long-run level only slowly, as well as the current asymmetry of monetary policy, whereby a negative shock is harder to offset.

- The Committee emphasized the data-dependent nature of future monetary policy and hesitance to commit to a specific pace, while stressing the importance of clear communication.

- Participants viewed the U.S. labor market improvement as "substantial." Labor resource underutilization was "appreciable" in cumulative terms, and the current unemployment rate near most participants' estimates of its longer-run levels. Most also expected the jobless rate to fall below its longer-run level this year before stabilizing. Partly for this reason, a number of participants noted that wage pressures should pick up soon, with some participants noting that they already had, helping speed up the rise in inflation to its target.

- Nearly all participants were now reasonably confident that inflation would move back to the 2% target over the medium term. Recent declines in oil prices alongside a rising greenback were expected to keep headline and import price growth more muted than previously thought, with persistent weakness in these prices highlighted as a downside risk to inflation. But, nearly all participants expected that the effects on headline and core inflation from falling energy and non-energy commodity costs would fade as those prices stabilized.

- The Committee generally saw through declines in market- and survey-based measures of inflation expectations, attributing much of the recent decline to overt sensitivity to energy prices as well as risk and liquidity premiums.

- Most participants agreed that the drag on U.S. economic activity from net exports will continue despite expectations of moderate improvement in global growth. At the same time, risks of further dollar appreciation, lower commodity prices, and emerging market weakness were highlighted by the Committee, with difficulties related to China's rotation in growth drivers specifically mentioned.

- The minutes highlighted that the recently passed Bipartisan Budget Act could lead to "modest boost to economic activity over the next few years" with businesses with federal contracts benefiting from reduced uncertainty in fiscal spending. Another major upside risk for the economy was seen from a potential boost from lower gasoline prices that has yet to materialize on real spending.

Key Implications

- The minutes from the landmark meeting during which the FOMC initiated rate lift-off paint a picture of increasing consensus on many fronts that were previously hotly debated. The degree of labor market improvement, the transitory nature of inflationary weakness, and the view that the U.S. economy remains somewhat insulated from external weakness were key among them.

- Importantly, the general agreement that global risks have diminished and that the jobless rate will continue to decline below its long-run level (and provide support for inflation going forward) allowed the Committee to rally behind a unanimous decision to begin the normalization process.

- Better yet, the Committee is also in general agreement on the idea that normalization will be gradual, and for good reasons. Plenty of risks loom abroad, with the exact strength of domestic economic momentum also top of mind. As such, the Committee is likely to proceed very cautiously, waiting to see for the impact of earlier moves before proceeding with further hikes. At this point, we expect the next move to come in March. But, the focus on data-dependence of this move should not be underestimated, with the current very weak tracking for economic growth in Q4 potentially giving the Fed some pause.

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