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# Economic Flash!

*September 20, 2017*

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## *FOMC Acts As Expected*

- Surprise, surprise: the Fed didn't hike rates, and did announce the start of its balance sheet reduction program. Everybody actually knew both of those outcomes, so the focus on what was said about rate hikes down the road. In particular, the median forecast sticks to the view that there is one more hike this year, and three more next year, but the target for 2019 and beyond is slightly flatter, with a "long run" target of 2.75% (vs the prior 3%). Four FOMC members don't see a hike this year, but one is looking for two.

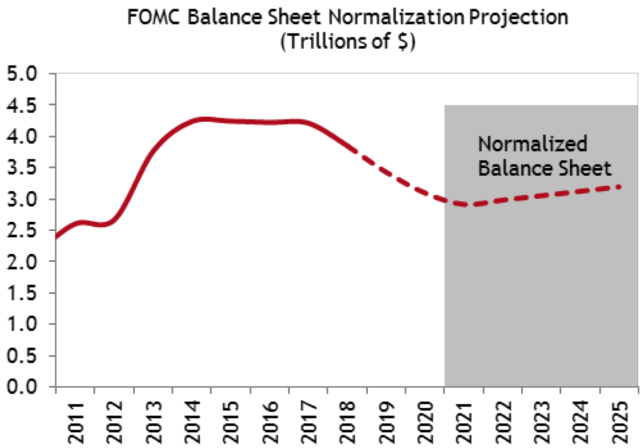
- The Fed's median forecast for a hike this year is in line with our own call. Its expectation for a further 75bps in 2018 is one-quarter point above our view, but both we and Fed are more hawkish than markets had been going into this announcement.

- The statement suggested that the Fed would be looking through the effects of hurricanes Harvey, Irma and Maria on US GDP, expecting there to be no material change in underlying economic momentum. It's the same story for inflation where the temporary effects of higher oil prices won't factor into central bankers' decision making on monetary policy. Policymakers actually upgraded their forecasts for 2017 GDP, supporting their case for another rate hike this year. Even the reduced forecasts for core PCE inflation for this year and next likely reflect the recent weakness observed in consumer prices rather than any significant concerns about monthly inflation ahead.

- On the balance sheet, the FOMC announced that it would begin the process of normalization in October. The Fed is beginning at a tempered pace, allowing only $6bn in Treasuries and $4bn in agency/MBS securities to roll off per month with the rest of the maturities being reinvested. That will ramp up over the course of the next twelve months to $50bn in total roll-offs, still well below the average monthly purchases during QE rounds. Over the long run, we expect the balance sheet will reach a trough much larger than that prior to the crisis mainly because of currency demands (Chart), thereby limiting the amount of pressure on Treasury yields.

- The lower long-run Fed Funds projection is now closer to our view that the neutral rate will sit at 2.5%, and supports our call that the selloff in longer-term Treasury yields will remain tame during this hiking cycle. The interest rate projections combined with the muted effect of the balance sheet announcement indicate that a bear-flattening of the yield curve lies ahead. Overall, today's announcements have been negative for the US bonds and positive for the currency.

## FOMC Balance Sheet Normalization Projection




*Source: FRBNY*