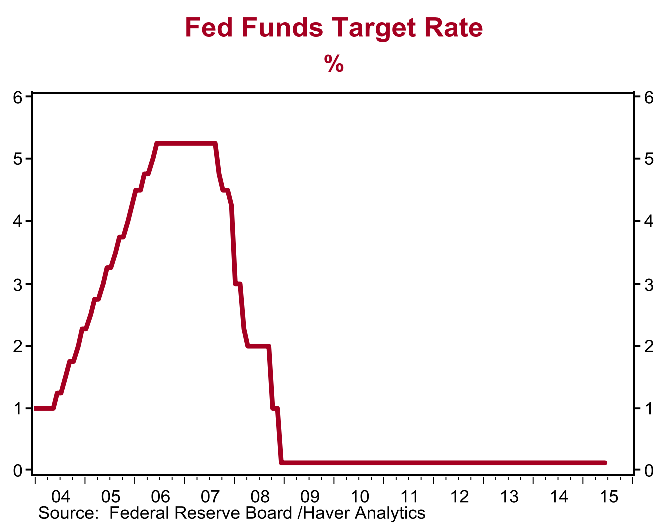
First Trust
ECONOMIC RESEARCH REPORT
Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Economist*
July 29, 2015 • 630.517.7756 • www.ftportfolios.com

September Hike Still on the Table

No one expected the Federal Reserve to make any changes to monetary policy at today's meeting and there were no surprises.

Although the Fed did not change interest rates, it did make some small changes to the language in the statement, upgrading its assessment of household spending, housing and especially the labor market, using stronger positive language such as: "labor market continued to improve", "solid job gains", and "declining unemployment." It also upgraded its view of labor market underutilization, finding that this underutilization has "diminished" compared to "diminished somewhat" at its last meeting.



The Fed continued to recognize both lower inflation (due to falling energy prices) and lower market-based measures of inflation expectations. The language about energy prices stabilizing was removed as oil has continued its downward slide. Ultimately, though, the Fed's forecast is that the eventual end of energy price declines as well as the improving labor market will push inflation back up toward its target of 2%, which we fully agree with.

One sign that the Fed is moving towards raising rates was a small language change in the statement from needing to see further improvement in the labor market to now only needing to see "some" further improvement.

That may be small, but it seems the Fed is getting to a point where it feels more comfortable with where the labor market is.

All of this adds up to the likelihood that the Fed will start hiking short-term rates in 2015. We think September, although it could come a little later and a rate hike in October shouldn't be casually dismissed.

Even though we were not expecting it, we believe the Fed should have raised rates today; the economy can handle it. Nominal GDP (real GDP growth plus inflation) has grown at a 3.5% to 4% annual rate for the past five years. That suggests a "neutral" monetary policy, one consistent with a stable general price level, would put the federal funds rate somewhere north of 3%. So even a 1% federal funds rate would leave monetary policy expansionary.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Dep. Chief Economist*

Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in June indicates that economic activity has been expanding moderately in recent months. Growth in household spending has been moderate and the housing sector has shown additional improvement; however, business fixed investment and net exports stayed soft. The labor market continued to improve, with solid job gains and declining unemployment. On balance, a range of labor market indicators suggests that underutilization of labor resources has diminished since early this year. Inflation continued to run below the Committee's longer-run objective, partly reflecting earlier declines in energy prices and decreasing prices of non-energy imports. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators continuing to move toward levels the Committee judges consistent with its dual mandate. The Committee continues to see the risks to the outlook for economic activity and the labor market as nearly balanced. Inflation is anticipated to remain near its recent low level in the near term, but the Committee expects inflation to rise gradually toward 2 percent over the medium term as the labor market improves further and the transitory effects of earlier declines in energy and import prices dissipate. The Committee continues to monitor inflation developments closely.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. The Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen some further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term.

The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Charles L. Evans; Stanley Fischer; Jeffrey M. Lacker; Dennis P. Lockhart; Jerome H. Powell; Daniel K. Tarullo; and John C. Williams.