

## Fed Sticks to Plan as Growth Remains Solid

June 14, 2017



As expected, the Federal Reserve raised its benchmark rate 25 basis points to 1% at the June Federal Open Market Committee (FOMC) meeting. Market participants largely priced in the rate hike and the Fed gladly took the opportunity to continue on its slow-and-steady pace of normalizing monetary policy. Some investors may be confused about the disconnect between the weak first quarter GDP reading of 1.2% and a Fed that continues to hike. One reason why the Fed has discounted last quarter's weak showing is the persistent seasonality associated with the first quarter. Weaker first quarters have been common since the 1990s but are even more evident in this cycle. According to Jefferies, GDP growth in first quarters since 2009 has averaged 1% compared to a collective average of the remaining quarters being 2.5%. That is a stark difference in growth and it would be unwise for the Fed to put too much faith in a seasonally weak reading.

More importantly, economic growth appears to be on solid footing for the foreseeable future. Labor markets continue to tighten, credit conditions are strong, U.S. Purchasing Managers Index readings continue to show healthy expansion and leading economic indicators are grinding higher. On the corporate front, we are coming off the strongest profit growth in the S&P 500 since 2011 as we distance ourselves from the energy-induced profit recession of 2015. One way to get an early gauge of economic activity is the Atlanta Fed's GDPNow assessment. Currently, the GDPNow forecast for the second quarter is showing 3.0% growth. This reading relies more on "hard data" or actual economic activity, such as new residential construction and trade in goods and services, and is viewed by many as a more conservative way to get a mid-quarter read on the economy.

The Fed also provided additional - and much anticipated - visibility on balance sheet normalization. In its statement following the FOMC meeting, the Fed outlined the timing and magnitude for the reduction of the assets on its \$4.5 trillion balance sheet. As expected, the tapering should be gradual in part, at least, to avoid a repeat of the 2013-style "taper tantrum." Specifically, the Fed stated it intends to "gradually reduce" its holdings of Treasury and agency securities from an initial \$6 billion per month to \$30 billion per month over the next 12 months. The plan affirmed our belief that the reduction will likely be slow and methodical over the course of several years. In any event, future meetings should give us more details on Fed's preferred route of reversing post-financial crisis quantitative easing.

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