United States

First, vote

- **The Fed left its monetary policy unchanged. Economic activity slowed, but the Fed esteems that this is only a passing trend.**
- **Certain signals concerning wage and pricing trends are not very encouraging, and could justify pausing until next fall before resuming the normalisation of monetary policy.**
- **As to fiscal policy, the repeal of Obamacare has dislodged tax reform on the list of priorities. We will have to wait for the release of CBO estimates to know what impact the new legislation will have on the economy.**

The Fed's monetary policy committee decided to leave key rates unchanged, but more than this decision, what the markets were really waiting for was the press release following the meeting. It is hard to imagine a rate increase without a press release, at least as long as key rates have not moved back into the Fed's comfort zone. In addition, the latest statistics for economic activity, employment and inflation, while not alarming, indicated that the US economy had slacked off at the beginning of the year.

As a result, GDP rose only 0.7% on an annualised quarterly basis, and year-on-year growth held below 2% for the sixth consecutive quarter. Between late 2016 and early 2017, the main explanation for this slowdown is household consumption, which grew at an annualised quarterly rate of only 0.3%, down from 3.5% in the previous period. This poor performance can be attributed to two factors: the slowdown in purchasing power gains and the upturn in the savings rate. The first factor was not due so much to revenues, which continued to increase mildly, but to higher tax payments and accelerating prices. Wage revenues even accelerated between Q4 2016 and Q1 2017, which allowed the Fed to talk about "robust fundamentals" and to expect a strong rebound in the second quarter. Moreover, the very first estimates of the Atlanta Fed's real-time Nowcast model point to second-quarter growth of 4.3%.

Investment and exports have picked up strongly. Given the relative weight of these components of demand, they failed to offset weak consumption, but assuming the later picks up, there could well be a strong rebound in second-quarter growth.

It is worth noting, however, the slowdown in the price indexes recently. Lifted by the rebound in oil prices, the personal consumption expenditure deflator (PCE) accelerated to 2.1% on a year-on-year basis in February, after holding below 1% from year-end 2014 to mid-2016. In March, the PCE deflator slipped back below the Fed's 2% target (to 1.9%). Excluding energy and food prices, the upturn in core inflation was not as strong (to 1.8% in mid-2016, from 1.3% in the year-earlier period), but the index slowed to a similar extent between February and March. The market-based PCE index, which excludes goods and services not actually supported by households, dropped back to an annual rate of 1.5%. This is not an alarming trend, and it might simply mark a levelling off before the upturn resumes.

GDP growth and its components

Quarterly growth, annualised rate, %	2017Q1	2016Q4	2016Q3
GDP	0.7	2.1	3.5
Final Domestic Demand	1.5	3.0	2.1
Private consumption	0.3	3.5	3.0
Government spending	-1.7	0.2	0.8
Fixed Investment	10.4	2.9	0.1
Residential	13.7	9.6	-4.1
Non residential	9.4	0.9	1.4
Equipment & Software	9.1	2.0	-4.5
Structures	22.1	-1.9	12.0
Intellectual Property Products	2.0	1.3	3.2
Change in inventories (contrib.)	-0.9	1.0	0.4
Net exports (contrib.)	0.1	-2.0	0.9
Exports	5.8	-4.5	10.0
Imports	4.1	8.9	2.2

Chart Source: US Bureau of Economic Analysis

Yet the Fed cannot ignore this slowdown at a time of persistently mild wage growth, especially when unemployment is so low. In April, the hourly wages of productive employment (excluding management) was up 2.3% for the year, whereas the unemployment rate was only 4.4%. The last time unemployment was this low, in 2006-2007, wage growth was on a 4% slope. Seen in this light, we can better understand why the Fed is maintaining an extremely accommodating monetary policy, and only intends to lift this bias very gradually.

In the latest update of their forecasts, FOMC members were still expecting two more key rate increases this year. Unless there is a more clear-cut rebound in employment and prices by the June FOMC meeting (scheduled for 13 and 14 June), the Fed will probably prefer to wait until the end of summer before resuming the normalisation of its monetary policy. In terms of fiscal policy, the situation is vaguer than ever. The only certainty is that there will not be any tax cuts before the next fiscal year. As we wrote these lines, the repeal of Obamacare has become a top priority again. The House of Representatives has just approved a bill by a slim majority. The bill must now be studied by the Senate, where a number of Republicans have already expressed reservations. For the moment, we do not know what impact this new legislation might have on the economy: the House voted on the text before the Congressional Budget Office (CBO) could even make any estimates.