# Deciphering the September Fed minutes

Expect more debate on inflation and financial conditions as the Fed gears up to hike in December

Source: Federal Reserve

Cast back to the September meeting and markets were left slightly taken aback by the lack of any major changes to the Fed's thinking on rate hikes. In spite of the softer recent inflation backdrop, the infamous dot diagram used to signal individual Fed policymaker's interest rate expectations stayed broadly unchanged.

But this is likely to mask some disagreement on some key issues, many of which are likely to be debated in today's Fed minutes. Here's what we'll be looking out for:

## Inflation: Temporary dip, or something more concerning?

There's still a disconnect between market pricing and the Fed's own rate hike projections, and much of that is down to the sharp fall in core inflation over the past few months. The Fed has been keen to point out that this reflects a range of "idiosyncratic", or temporary, factors. For instance, taking a quirk in mobile data contracts out of the picture would lift most inflation measures by roughly 0.2ppt.

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Some Fed members have also pointed at seasonal adjustment issues that typically result in lower core PCE inflation readings in the second half of the year (the same phenomenon that often depresses first quarter growth).

We also expect inflation to gradually pick up again over the next few months, partly as the weaker dollar filters through. And even though the jury is still out over Friday's huge wage growth figure given recent hurricanes, backward revisions and increasing job-to-job flows should give the Fed some confidence that the tight jobs market is pushing up pay.

But with a number of Fed officials (Neel Kashkari in particular) becoming more vocal about the dip in inflation, markets will be scrutinising the minutes for any signs of doubt creeping into the Fed's core view.

## Financial conditions: A reason to hike, or not?

Over the past couple of months, we've seen a range of policymakers refer to stretched asset valuations as the Fed seeks to broaden out its rate hike rationale. Higher stock prices, lower volatility and low bond yields equals easier financial conditions, which in theory means the Fed should hike faster.

Or does it? In the last set of minutes, some dovish members noted that, given secular stagnation and lower yields, higher asset prices may not imply financial conditions are as easy as might have been the case pre-crisis.

This doesn't appear to be the core view amongst the Fed and at this stage is unlikely to slow the Fed down on rate hikes. But the debate is likely to get further airtime in today's set of Fed minutes.

## Bottom line

Given the decent economic backdrop and potential for a gradual inflation improvement, we expect the Fed to hike again in December. But the big risk at this stage is the politics. The debt ceiling deadline comes days after the December meeting, and if it goes to the wire, the resulting market volatility could persuade the Fed to temporarily hold fire - although that's not our base case.

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