U.S. FOMC Review

- FOMC: hawkish in the short run; dovish from a long-run perspective

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A Likely Rate Hike This Year

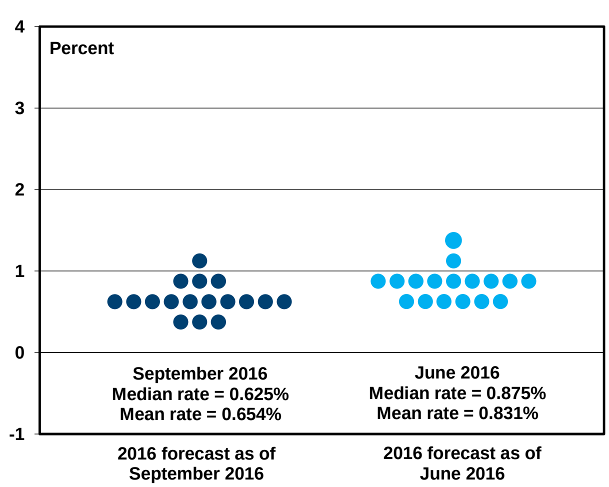
Three elements of the policy statement provided strong hints that the Federal Open Market Committee is likely to raise interest rates this year. First, the statement included a balance of risk assessment, noting that the risks to the outlook were equally balanced on the upside and downside. The Committee dropped such a statement beginning in January because the outlook was too uncertain to provide an assessment (but implying that officials were concerned about a flagging economy). The inclusion at this time suggests that officials have become more comfortable with the economic environment and therefore more willing to hike interest rates.

Second, the Committee inserted a new sentence indicating that the case for higher interest rates had strengthened, confirming that officials are indeed comfortable with the economy's performance and implying that they are close to tightening.

Third, three officials dissented in favor of tightening -- an unusually large number of dissents. Interestingly, one of the dissenters -- Eric Rosengren of the Boston Fed -- had previously been an ardent supporter of accommodative policy. He has now placed himself in the hawkish camp. His shift is not shocking because his recent speeches have indicated that he is prepared to proceed with normalization, but dissenting from a Committee decision is a bolder step than articulating a new slant in speech.

The Committee does not often register three dissents. The last time such a vote occurred was December 2014, but the dissenters had divergent objections to the decision to hold the substance of policy steady and to tweak forward guidance: one wanted easier policy, one wanted tighter policy, and one didn't like the new wording. The last time three officials dissented in the same direction was in August and September 2011 when three officials did not favor additional accommodation (friendlier forward guidance in August and the start of operation twist in September).

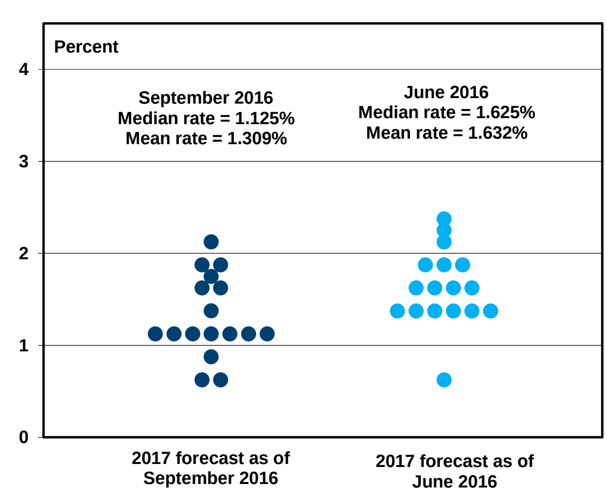
Expected Fed Funds Rate (Year-End 2016)*



Each dot represents the expected federal funds rate of a Fed official. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the time of the September meeting.

Source: Federal Open Market Committee

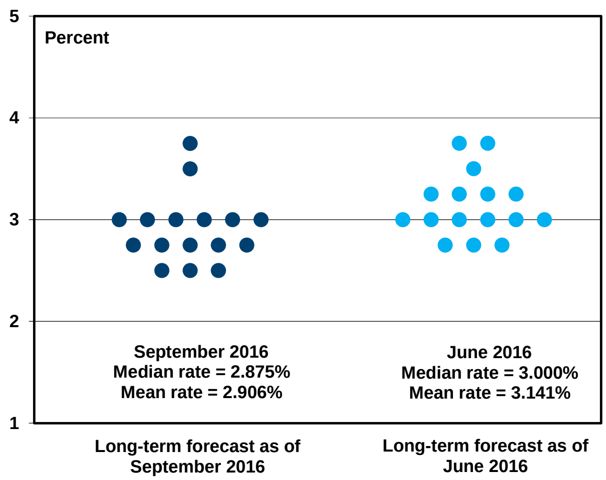
Expected Fed Funds Rate (Year-End 2017)*



Each dot represents the expected federal funds rate of a Fed official. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the time of the September meeting.

Source: Federal Open Market Committee

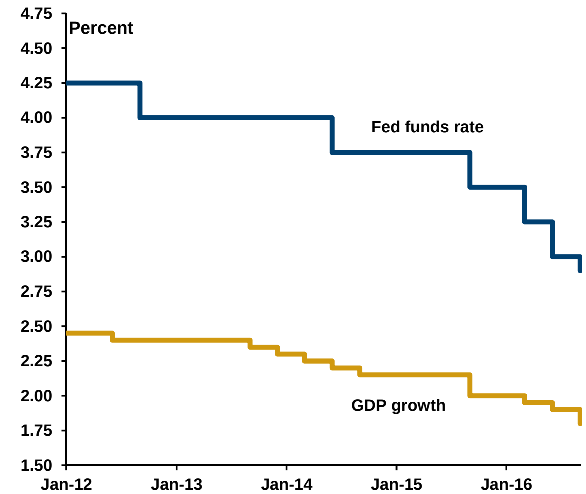
Expected Fed Funds Rate (Long Run)*



Each dot represents the expected federal funds rate of a Fed official. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the time of the September meeting and one Fed official did not submit a long-term projection.

Source: Federal Open Market Committee

FOMC: Long-Run Expectations*



The chart shows the median forecast of FOMC participants for the target level of the federal funds rate in the long run and the midpoint of the central tendency forecast for longer run GDP growth.

Source: Federal Open Market Committee

The Long Run

While the FOMC signaled a high probability of tighter policy before the end of the year, longer-run expectations were more subdued than they were in June, when the Committee last presented a set of interest rate projections. The Committee, although it expects to tighten this year, now sees only one move according to the median (and mean) of the dot plot, down from two tightenings in June (charts, p. 1). For 2017, the FOMC now sees two tightenings versus three in June. In addition, the long-run view of the federal funds rate, which could be viewed as the collective assessment of the neutral rate, inched lower again -- the fourth shift in the past five rounds of projections (charts, above).

The FOMC also reduced its view of long-run GDP growth, which could be viewed as the Committee's collective assessment of potential growth -- now 1.8 percent versus in 2.0 percent in June. The combination of revisions to the long-run views on economic growth and interest rates suggests that policymakers are drifting toward views consistent with secular stagnation.

The Press Conference

The press conference of Chair Yellen involved a few interesting tidbits. She felt a need to explain why the Committee decided to hold policy steady despite the stronger case for a move. She noted that officials were impressed with the pickup in labor force participation, which led them to conclude that the economy had a bit more "running room." In addition, she noted that inflation was below target and showing no sign of accelerating.

While three officials dissented, she noted that the divergence of views among policymakers was not pronounced. The key difference in views involved timing rather than direction.

Her comments supported the view that officials see a slow rate of potential growth and a low level of neutral interest rates. She characterized the federal funds rate as only "slightly" below normal and she indicated that policy was only "modestly" accommodative.

A few reporters raised the issue of political influence, but Chair Yellen argued strongly that politics did not enter the Fed's discussions. She also indicated that November will be a live meeting despite the fact that the election will occur one week later.

We were a bit disappointed in the press conference in that it appeared to be a staged affair. She seemed to be reading some of her answers, or repeating views that were well rehearsed. We had the impression that the questioners were selected in advance, as the names of reporters appeared on the screen very quickly, as if the broadcast technician knew who would be next. In one instance, a reporter was misidentified, with his name given as the next reporter in the queue -- the broadcast technician apparently moved too quickly down his or her list.

Economic Projections of the FOMC, September 2016*

	2016	2017	2018	2019	Longer Run
Change in Real GDP	1.8	2.0	2.0	1.8	1.8
June projection	2.0	2.0	2.0	--	2.0
Unemp. Rate	4.8	4.6	4.5	4.6	4.8
June projection	4.7	4.6	4.6	--	4.8
PCE Inflation	1.3	1.9	2.0	2.0	2.0
June projection	1.4	1.9	2.0	--	2.0
Core PCE Inflation	1.7	1.8	2.0	2.0	--
June projection	1.7	1.9	2.0	--	--
Federal funds rate	0.6	1.1	1.9	2.6	2.9
June projection	0.9	1.6	2.4	--	3.0

* *Median projections*
Source: Supplemental materials released with the September 21, 2016 FOMC Statement