U.S. FOMC Review

- FOMC: few surprises, but a tad more hawkish than in December

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The Dots

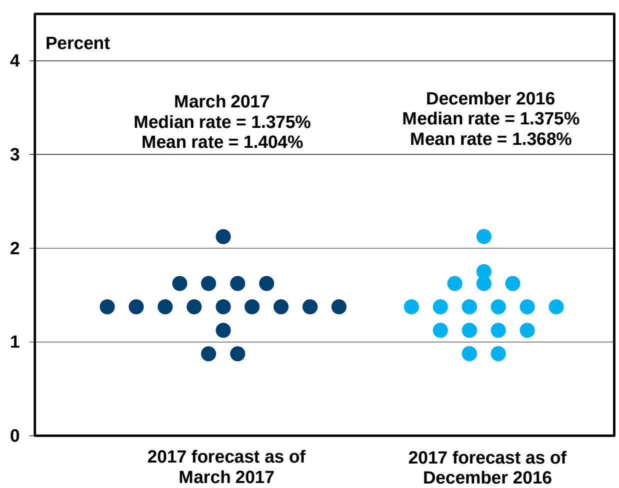
The median expectations for the federal funds rate were unchanged for both 2017 and 2018, a friendlier outcome than envisioned by some market participants (and hence a favorable market reaction). However, the mean rates increased slightly for both years, which could be viewed as giving a hawkish tilt to the expectations of Fed officials.

The most notable change for 2017 was an upward shift in three dots that previously were below the median (three below median in March versus six in December). The upward revisions in these views simply put more individuals at the median rate that existed in December. As in December, there were five officials with rate expectations above the median, although one toned down his or her view with a one-quarter point reduction. Although the median of the distribution was unchanged, the mean rose slightly (1.404 percent versus 1.368 percent), reflecting the upward shift in the views of three doves partially offset by the downward adjustment of one hawk. The new distribution of views was tighter than the one in December (standard deviation of 0.292 percentage point versus 0.320), which we view as significant in that it signals that officials are in closer alignment of views.

For 2018, four doves shifted views (three now below the median versus seven in December), and one neutral official became a tad more hawkish (8 officials now above the median versus seven in December). Again, the median of the distribution was unchanged, but the mean rose by almost 9 basis points (2.316 percent versus 2.228 percent). The dispersion of views for 2018 was still quite wide, signaling a great deal of uncertainty on how monetary policy will proceed.

The median rate for 2019 moved slightly higher, but like the outlook for 2018, the wide dispersion of views suggests a high degree of uncertainty.

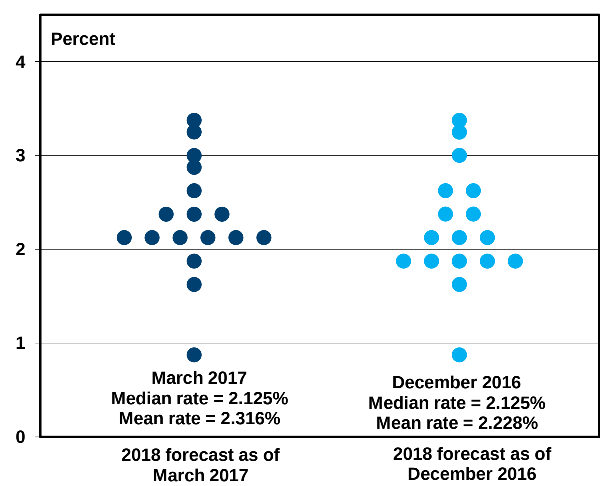
Expected Fed Funds Rate (Year-End 2017)*



** 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 March meeting.*

Source: Federal Open Market Committee

Expected Fed Funds Rate (Year-End 2018)*



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The Policy Statement

The policy statement of the FOMC was little changed from that in January/February, but like to dot plot, the changes in the statement had a hawkish tilt. In assessing the current state of the economy, the new statement indicated that business investment had firmed somewhat, a contrast from the previous characterization of soft business spending. In addition, in offering forward guidance, the new statement indicated that economic conditions were likely to “warrant gradual increases in the federal funds rate”; in previous statements, the Committee expect “only gradual increases”. Dropping “only” from the current statement could be viewed as opening a door for something more than gradual. A reporter at the press conference asked Chair Yellen about this wording change, and she downplayed its significance.

We found another change of the statement to be mildly interesting, although we would not push too hard on this view. In previous statements, the Committee indicated that it expected inflation to rise to two percent over the medium term. With inflation now close to two percent, the new statement indicated that the Committee expected inflation to “stabilize around two percent”, and it indicated that officials hoped to achieve “sustained” two percent inflation. Seeking “stable” and “sustained” inflation could be viewed as a hint that the Committee will not be seeking to achieve inflation above two percent to compensate for below-target inflation in the prior four years. Officials might be willing to tolerate inflation above two percent for a time given recent history, but they are not likely to be seeking inflation above two percent because of past undershoots.

The Press Conference

We did not find the press conference to be especially illuminating. The most interesting question involved the Committee’s plans for the balance sheet. The Committee plans to continue reinvestment of security repayments until policy normalization is “well under way” When asked to define well under way, Chair Yellen indicated that qualitative considerations rather than a specific level of the federal funds rate would determine the timing of balance sheet adjustment. Specifically, she noted that a change would occur when the Committee had confidence in the trajectory of the economy and saw limited downside risks to the outlook.

Two question related to the timing of this policy change (earlier than envisioned by most market participants at the start of the year). Chair Yellen indicated that market participants should not have been surprised. The Committee indicated in December that normalization would continue if the economy performed as expected -- and it has. This explanation certainly is adequate, but we suspect that the easing in broad financial conditions (the increase in stock prices and the tightening in credit spreads) played a role.

Economic Projections of the FOMC, March 2017*

	2017	2018	2019	Longer Run
Change in Real GDP	2.1	2.1	1.9	1.8
December projection	2.1	2.0	1.9	1.8
Unemp. Rate	4.5	4.5	4.5	4.7
December projection	4.5	4.5	4.5	4.8
PCE Inflation	1.9	2.0	2.0	2.0
December projection	1.9	2.0	2.0	2.0
Core PCE Inflation	1.9	2.0	2.0	--
December projection	1.8	2.0	2.0	--
Federal funds rate	1.4	2.1	3.0	3.0
December projection	1.4	2.1	2.9	3.0

* *Median projections*
Source: Supplemental materials released with the March 15, 2017 FOMC Statement