U.S. FOMC Review

- FOMC: a hawkish tilt; less forward guidance

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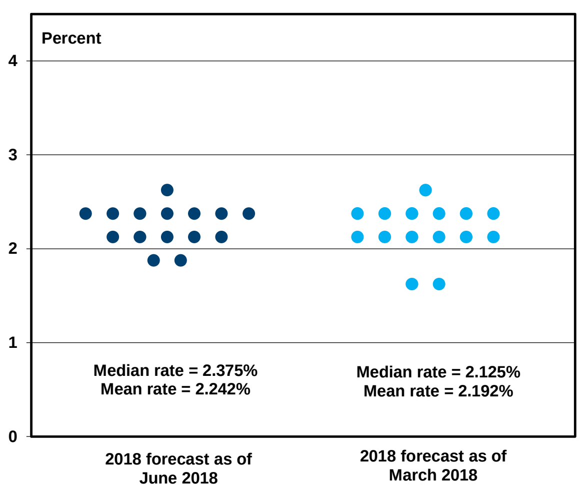
FOMC: A Small, but Notable, Shift in the Dots

The new dot plot released by the Federal Open Market Committee today showed an upward shift for 2018. The change was small, but it was enough to shift the median dots 25 basis points higher to 2.375 percent. That is, the median dot is now suggesting four tightenings this year rather than three. In March, the plot showed an even split between officials expecting three and four tightenings (six each); the new plot shows seven officials expecting four tightenings and five expecting three (chart, below left). The two officials in the low end of the spectrum in March added two tightenings to their expectations for this year, but this was almost inevitable, as one policy change had occurred in March, and the Committee seemed likely to act at this meeting as well. These two doves are not expecting any further changes this year.

The median dot for 2019 also ticked one-quarter point higher to 3.125 percent, although the number of expected shifts remained at three. The distribution of views on policy next year tightened (a range of 1.75 percentage points versus 2.25 percentage points in March). However, the dispersion for next year is still quite wide, suggesting a high degree of uncertainty on policy (chart, right).

The dot plot suggested more tightenings this year, and so too did the Summary of Economic Projections (SEP; see p. 2). The expected unemployment rate at the end of this year and next is lower than previously believed, while the expected inflation rate is higher, suggesting a need for more action from the Fed. Also important, the unemployment rate expected to prevail in the long-run did not change at 4.5 percent. A reduction in this rate would have suggested that officials saw an additional amount of slack in the labor market. The steady long-run rate suggests that officials see the economy moving even further beyond full employment, which raises risks of faster inflation or asset bubbles.

Expected Fed Funds Rate (Year-End 2018)*



Each dot represents the expected federal funds rate of a Fed official at the end of 2018. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but four governorships were open at both the June 2018 and March 2018 meetings.
Source: Federal Open Market Committee

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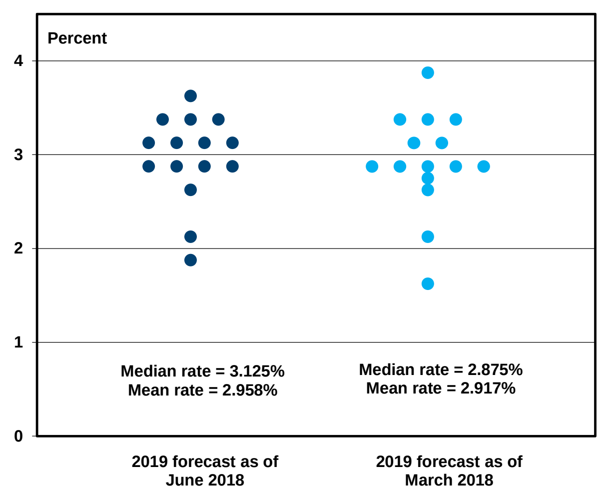

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The policy statement released by the Committee involved several changes. Most important, the FOMC offered less forward guidance than in the past. Specifically, the Committee dropped the portion indicating that economic conditions were likely to warrant gradual increases in the federal funds rate and that the rate would remain, for some time, below the level expected to prevail in the long run. We did not see this portion of the statement as adding meaningful information, and apparently the FOMC agreed. We already know that the Fed is raising rates gradually, and the dot plot shows that policy will shift from accommodative to neutral or restrictive next year. The guidance in the statement was vague and superfluous.

Past policy statements have described the Committee's policy stance as "accommodative". The minutes from the May meeting suggested that the upcoming statements might change this characterization, but the Committee did not make such a shift at this time. Continuing with the "accommodative" description is not surprising, as the new target of the federal funds rate of 1.75 to 2.00 percent is still below the median estimate of the federal funds rate expected in the long run (2.9 percent). With the target federal funds rate approximately one percentage point below the median estimate of the neutral rate (and below the lower bound of the range of estimates, 2.3 percent), officials can still characterize policy as accommodative.

In response to the FOMC's decision to raise the federal funds rate by 25 basis points, the Board of Governors raised the interest rate on excess reserves by 20 basis points to 1.95 percent. The smaller change in IOER represented a break from the recent pattern of changing the rates on both excess reserves and reverse repurchase agreements by the same amount as the shift in the fed funds rate. We do not view the smaller change in IOER to be especially important. It merely represents a technical change to tighten control over the federal funds rate. Federal funds in recent weeks have been trading in the upper portion of the target ranges (1.70 percent in May and early June, only 5 basis points below the upper bound). The lower rate on excess reserves should nudge the FFR closer to the midpoint of the range. The only policy significance of the shift in IOER is that it signals that the FOMC wants the fed funds rate close to the midpoint rather than in the upper portion of the range.

Economic Projections of the FOMC, June 2018*

	2018	2019	2020	Longer Run
Change in Real GDP	2.8	2.4	2.0	1.8
March projection	2.7	2.4	2.0	1.8
Unemp. Rate	3.6	3.5	3.5	4.5
March projection	3.8	3.6	3.6	4.5
PCE Inflation	2.1	2.1	2.1	2.0
March projection	1.9	2.0	2.1	2.0
Core PCE Inflation	2.0	2.1	2.1	--
March projection	1.9	2.1	2.1	--
Federal funds rate	2.4	3.1	3.4	2.9
March projection	2.1	2.9	3.4	2.9

* *Median projections*

Source: Supplemental materials released with the June 13, 2018 FOMC Statement