U.S. FOMC Review

- FOMC: close to neutral, but still likely to continue tightening

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FOMC

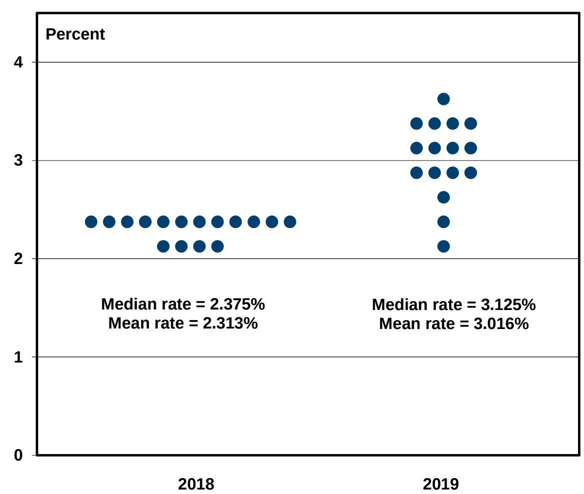
Today's meeting of the Federal Open Market Committee involved little uncertainty about the 25-basis-point rate hike to the range of 2.00 to 2.25 percent. However, there was considerable importance to how the Committee characterized its policy stance. Previous statements noted that policy was "accommodative", but the new statement dropped this assessment. The absence of this sentence could be viewed as a signal that officials now saw policy as neutral, which could open a door to a pause in the tightening process. At the extreme, officials might argue that normalization is complete.

However, we would not push the absence of this sentence too far -- in fact, not far at all. Policy is still probably tilting on the accommodative side. Public statements of some Fed officials have suggested that neutral policy involves a real federal funds rate of 0.5 to 1.0 percent; the current real rate after today's change is only slightly above zero. Chair Powell in the Q&A session admitted in response to a question that policy can still be viewed as accommodative despite the absence of the sentence. Powell noted that the absence of the statement merely indicated that the economy was evolving as the Committee expected and therefore it would continue to follow the anticipated path of policy.

That path outlined in the dot plot showed the Fed tightening further. The median dot for the end of 2018 showed one additional tightening, most likely in December. The median dot in the plot for 2019 involves three tightenings (chart). However, the dispersion of dots for next year was still quite wide, signaling wide variation in views among Fed officials and therefore uncertainty on what might unfold. We are looking for three tightenings next year, but we also recognize the uncertainty involved. The issue of restrictive policy arose in the Q&A session, and Chair Powell indicated that there could be modest overshoots of neutral policy.

The new economic projections did not involve major changes. Economic growth this year and next was slightly stronger than previously expected, most likely reflecting the strength in Q2 and the apparent continued firm performance in Q3 (3.0 percent or perhaps a touch faster). Despite firmer growth, the Committee did not see a pickup in the inflation rate and it saw unemployment at the end of this year a touch firmer. The long-run federal funds rate moved one tick higher to 3.0 percent, but this change could have reflected the addition of a new member (Fed Governor Richard Clarida) rather than a rethinking of the equilibrium rate (table, next page).

Expected Fed Funds Rate (Year End '18 & '19)



* *Each dot represents the expected federal funds rate of a Fed official at the ends of 2018 and 2019. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but three governorships were open at the September 2018 meeting.*

Source: Federal Open Market Committee

The Q&A session did not bring major revelations. The range of questions included trade frictions, potential problems in emerging markets, easy conditions in financial markets and potential financial instabilities. The Chairman, in all cases, answered that the issues were important and that the Fed was monitoring them carefully. We found one tidbit interesting. Mr. Powell noted that an increase in prices associated with tariffs might be viewed as a one-time change rather than a pickup in the underlying inflation rate. Fed officials, therefore, might view such shifts as transitory and not worthy of faster tightening.

Economic Projections of the FOMC, September 2018*

	2018	2019	2020	2021	Longer Run
Change in Real GDP	3.1	2.5	2.0	1.8	1.8
June projection	2.8	2.4	2.0	--	1.8
Unemp. Rate	3.7	3.5	3.5	3.7	4.5
June projection	3.6	3.5	3.5	--	4.5
PCE Inflation	2.1	2.0	2.1	2.1	2.0
June projection	2.1	2.1	2.1	--	2.0
Core PCE Inflation	2.0	2.1	2.1	2.1	--
June projection	2.0	2.1	2.1	--	--
Federal funds rate	2.4	3.1	3.4	3.4	3.0
June projection	2.4	3.1	3.4	--	2.9

* *Median projections*
Source: Supplemental materials released with the September 26, 2018 FOMC Statement