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Data Insights: Federal Reserve

Wednesday, December 17, 2014

Today's FOMC statement: how the language changed from prior meeting

Release Date: ~~October 29~~December 17, 2014

Information received since the Federal Open Market Committee met in ~~September~~October suggests that economic activity is expanding at a moderate pace. Labor market conditions improved ~~somewhat~~ further, with solid job gains and a lower unemployment rate. On balance, a range of labor market indicators suggests that underutilization of labor resources ~~is gradually diminishing.~~continues to diminish. Household spending is rising moderately and business fixed investment is advancing, while the recovery in the housing sector remains slow. Inflation has continued to run below the Committee's longer-run objective~~.~~, partly reflecting declines in energy prices. Market-based measures of inflation compensation have declined somewhat further; survey-based measures of longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators ~~and inflation~~ moving toward levels the Committee judges consistent with its dual mandate. The Committee sees the risks to the outlook for economic activity and the labor market as nearly balanced. ~~Although~~The Committee expects inflation ~~in~~to rise gradually toward 2 percent as the ~~near term will likely be held down by~~ labor market improves further and the transitory effects of lower energy prices and other factors~~, the~~ dissipate. The Committee ~~judges that the likelihood of~~continues to monitor inflation ~~running persistently below 2 percent has diminished somewhat since early this year~~developments closely.

~~The Committee judges that there has been a substantial improvement in the outlook for the labor market since the inception of its current asset purchase program. Moreover, the Committee continues to see sufficient underlying strength in the broader economy to support ongoing progress toward maximum employment in a context of price stability. Accordingly, the Committee decided to conclude its asset purchase program this month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.~~

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that the current 0 to 1/4 percent target range for the federal funds rate remains appropriate. In determining how long to maintain this target range, the Committee will assess progress-

-both realized and expected--toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. ~~The Committee anticipates, based on its current assessment,~~Based on its current assessment, the Committee judges that it can be patient in beginning to normalize the stance of monetary policy. The Committee sees this guidance as consistent with its previous statement that it likely will be appropriate to maintain the 0 to 1/4 percent target range for the federal funds rate for a considerable time following the end of its asset purchase program ~~this month~~in October, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored. However, if incoming information indicates faster progress toward the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.

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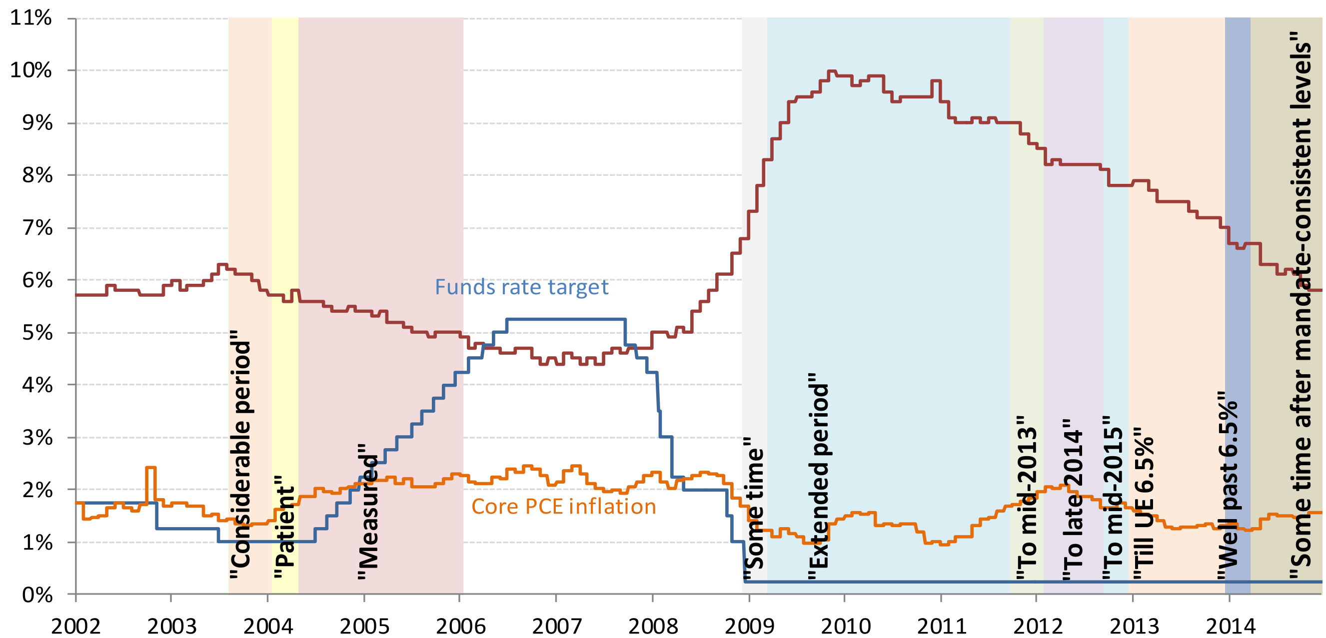
When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Stanley Fischer; ~~Richard W. Fisher; Loretta J. Mester; Charles I. Plosser; Jerome H. Powell; and Daniel K. Tarullo. Voting against the action was Narayana Kocherlakota, who believed that, in light of continued sluggishness in the inflation outlook and the recent slide in market-based measures of longer-term inflation expectations, the Committee should commit to keeping the current target range for the federal funds rate at least until the one-to-two-year ahead inflation outlook has returned to 2 percent and should continue the asset purchase program at its current level~~Loretta J. Mester; Jerome H. Powell; and Daniel K. Tarullo.

Voting against the action were Richard W. Fisher, who believed that, while the Committee should be patient in beginning to normalize monetary policy, improvement in the U.S. economic performance since October has moved forward, further than the majority of the Committee envisions, the date when it will likely be appropriate to increase the federal funds rate; Narayana Kocherlakota, who believed that the Committee's decision, in the context of ongoing low inflation and falling market-based measures of longer-term inflation expectations, created undue downside risk to the credibility of the 2 percent inflation target; and Charles I. Plosser, who believed that the statement should not stress the importance of the passage of time as a key element of its forward guidance and, given the improvement in economic conditions, should not emphasize the consistency of the current forward guidance with previous statements.

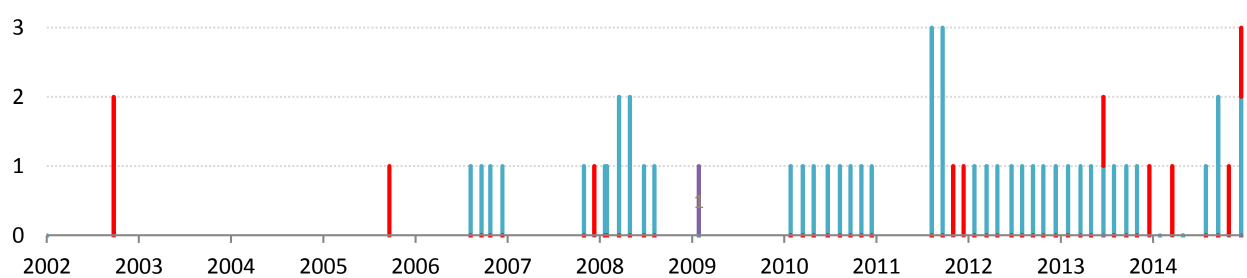
Source: FOMC, TrendMacro analysis

Fedspeak regime change: the evolution of forward guidance



Source: FOMC, Federal Reserve H.15, BLS, BEA, TrendMacro calculations

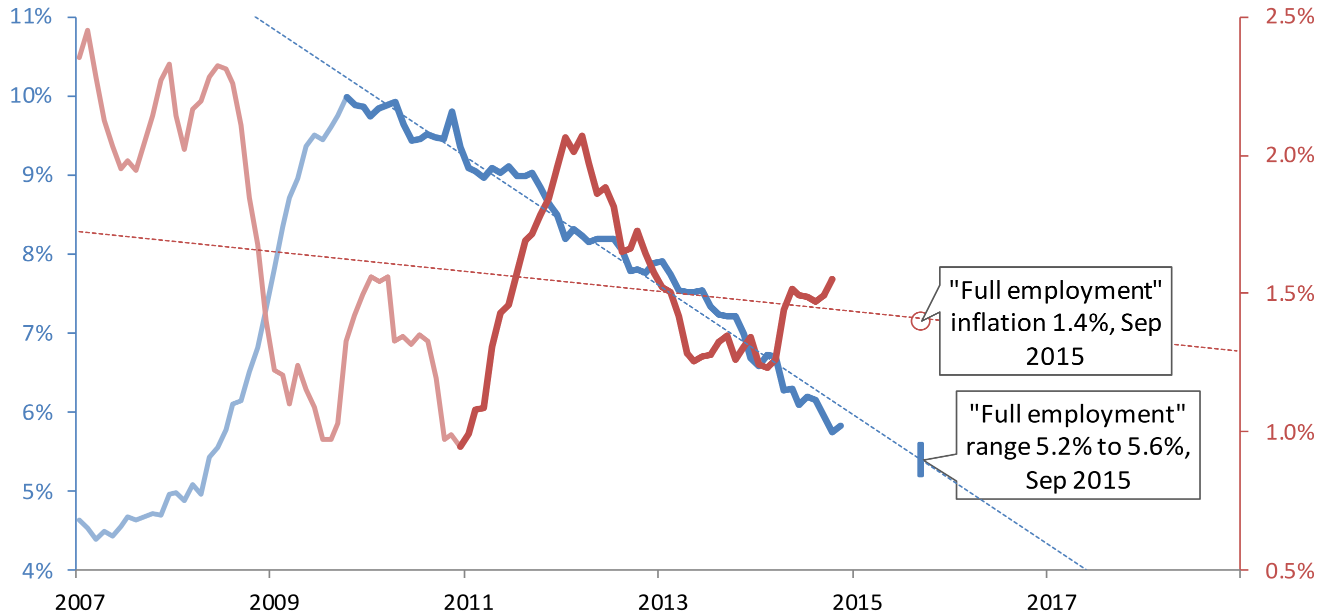
Other voices: number of FOMC decision dissents



Source: FOMC, TrendMacro calculations

Yellen beyond the Evans Rule: the outer limit of the zero bound

Unemployment rate ··· Trend from peak — Core PCE inflation YOY ··· Trend from trough

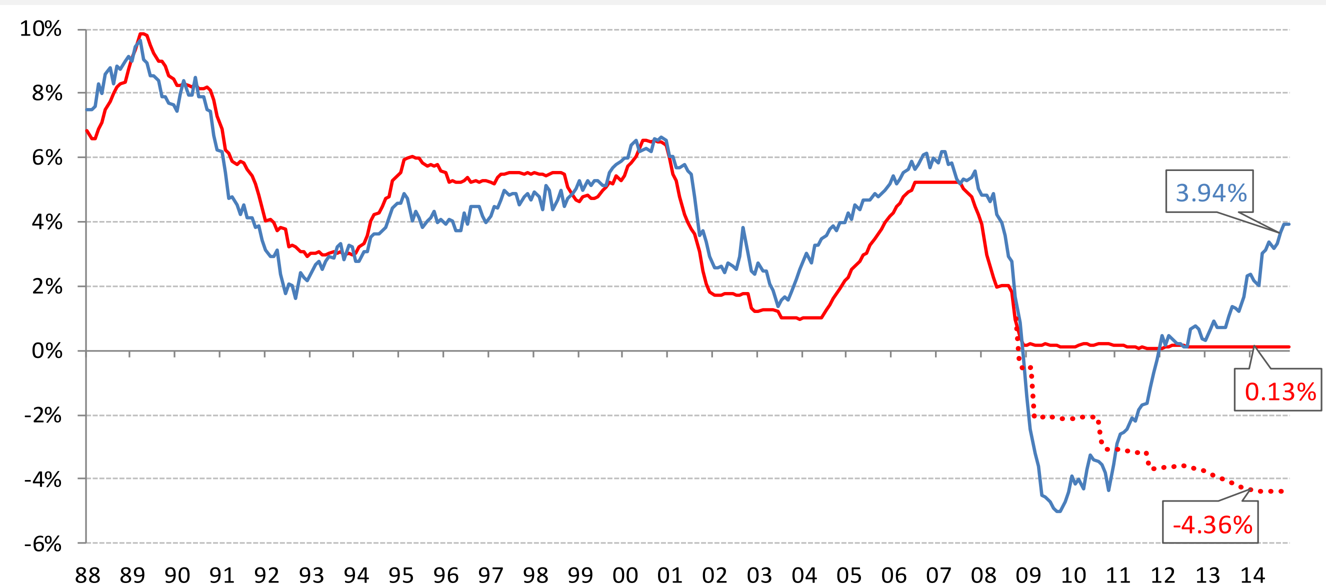


Source: BLS Current Population Survey, TrendMacro calculations

Yellen's Taylor Rule (per Rudebusch 2009): Is the Fed tight or loose?

Rule: 2.07 + 1.28 x 12-mo core PCE inflation - 1.95 x (UE - CBO natural rate)

— Actual funds rate ···· Balance sheet-augmented funds rate

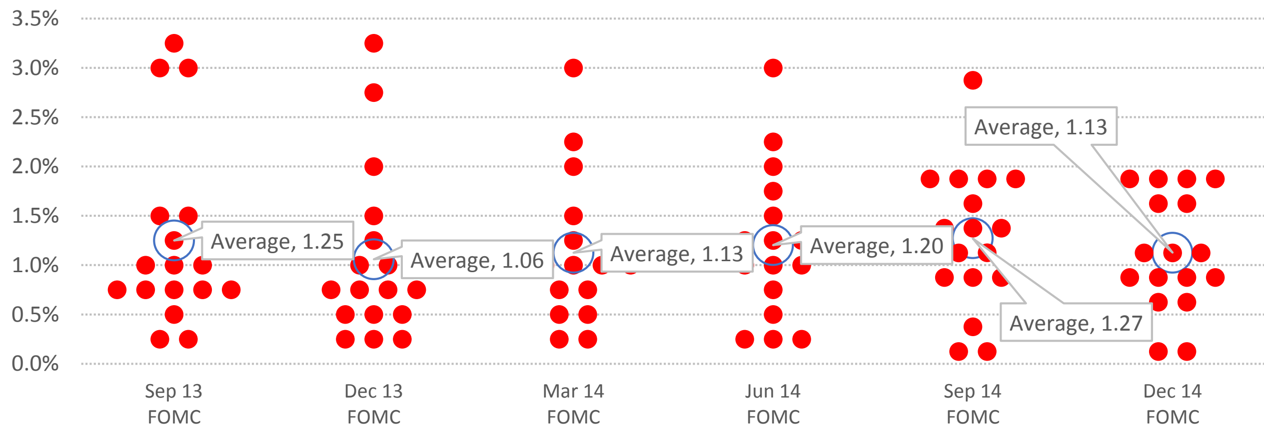


Source: BLS, BEA, TrendMacro calculations

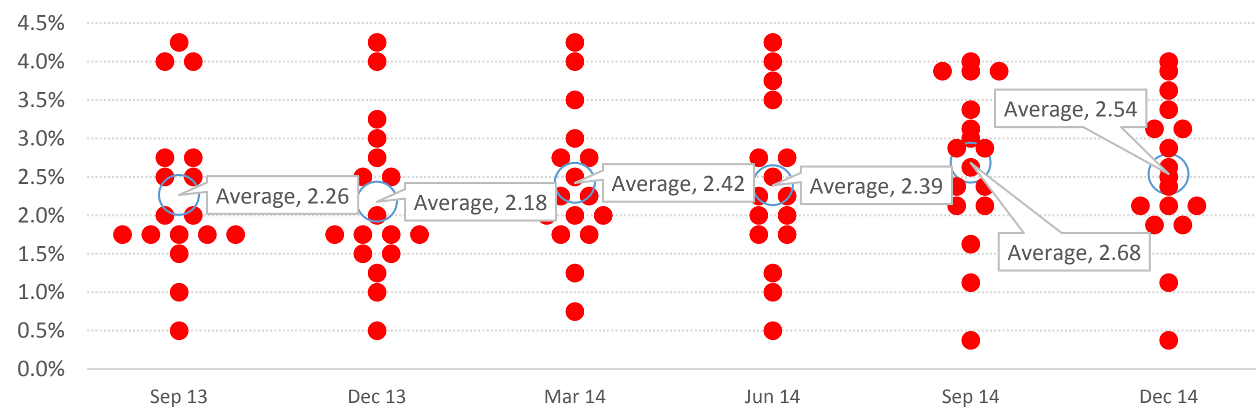
Tracking the "dotplots"

FOMC participants' estimate of "appropriate" target fed funds rate ● Vote by individual participant

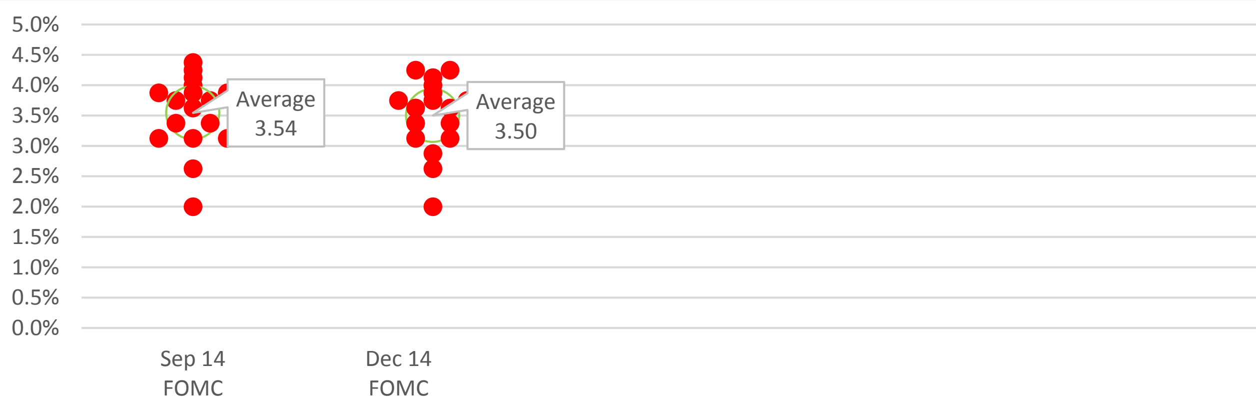
For year-end 2015



For year-end 2016



For year-end 2017

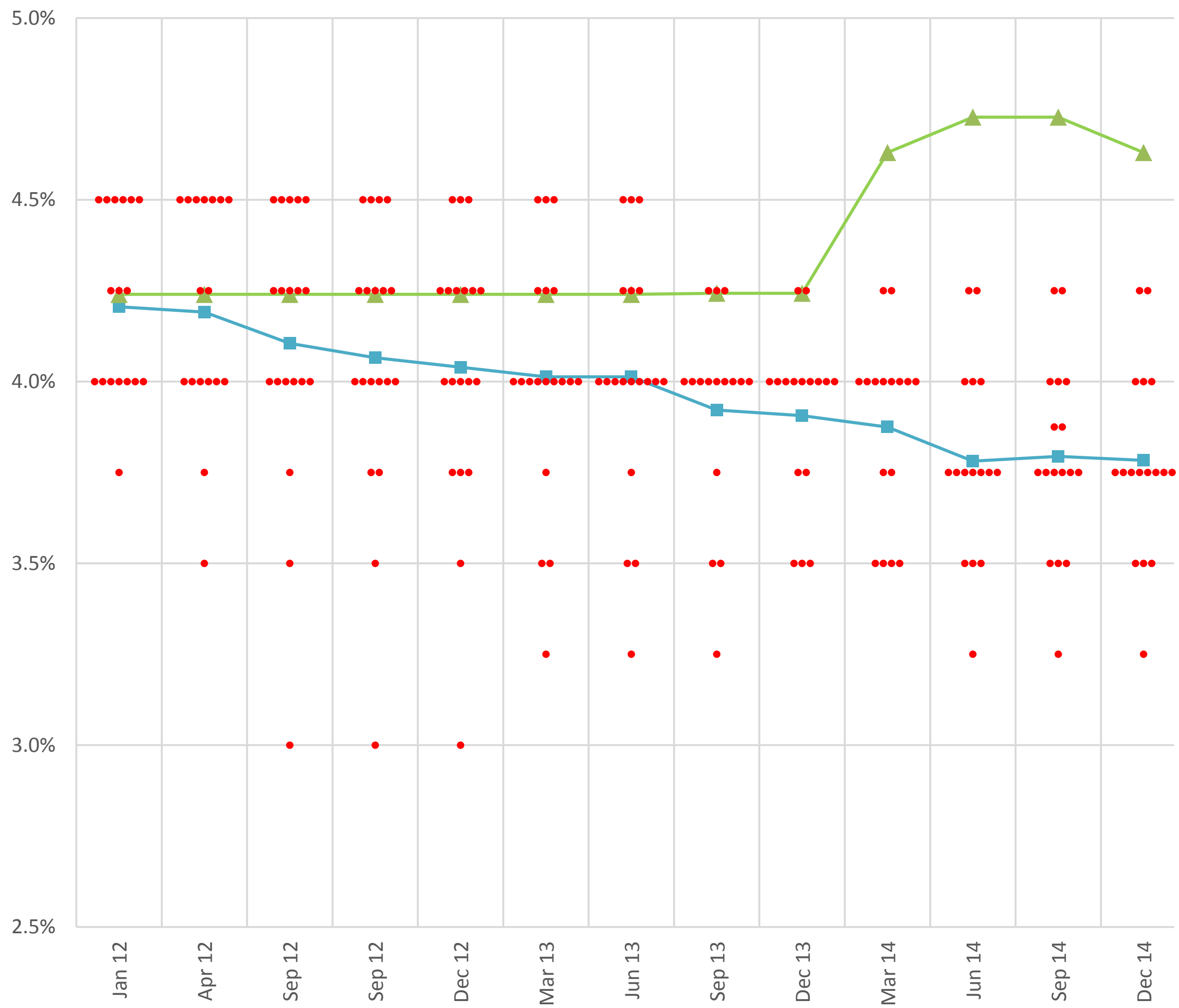


Source: Federal Reserve, TrendMacro calculations

The ultimate dots

FOMC participants' estimate of "appropriate" target fed funds rate ● Vote by individual participant
■ Weighted average ▲ Taylor Rule rate based on participants' core PCE and UE estimates

For "longer run"

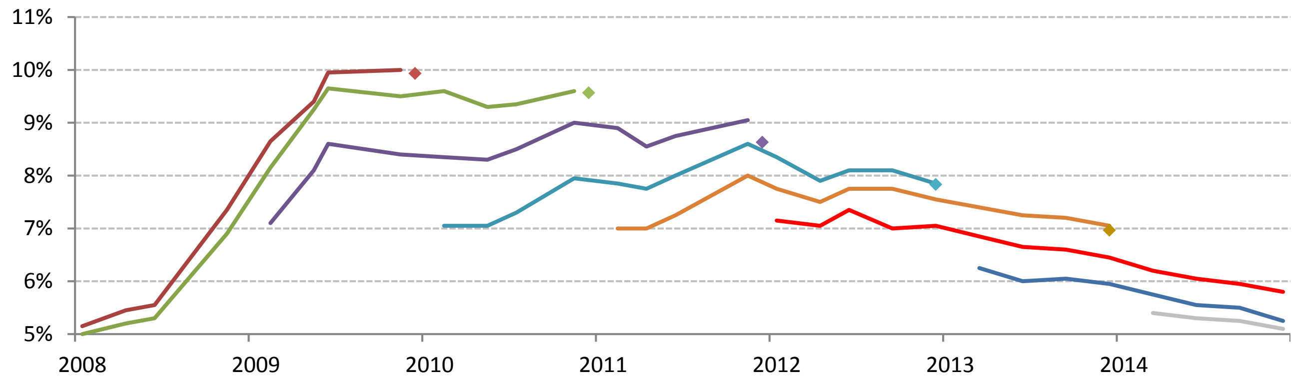


Source: Federal Reserve, TrendMacro calculations

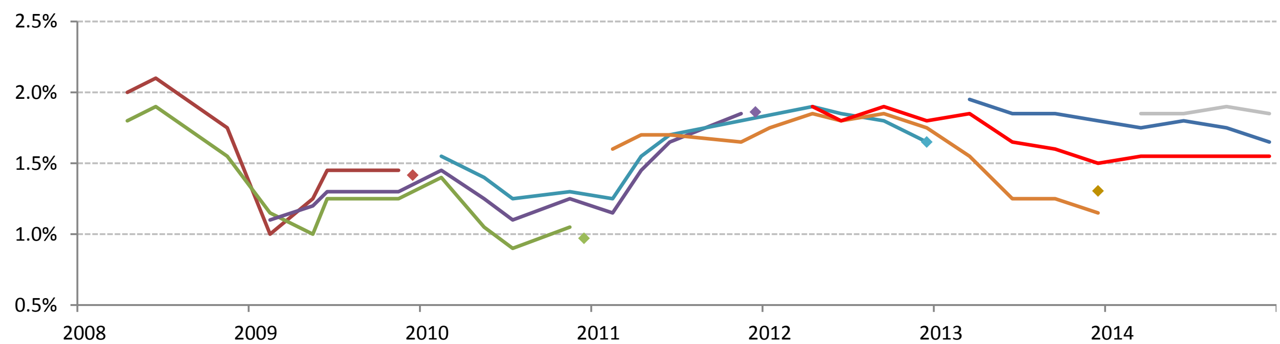
Forecast versus actual: economic projections of the FRB and the presidents

— Forecast ◆ Actual ■ for 2009 ■ 2010 ■ 2011 ■ 2012 ■ 2013 ■ 2014 ■ 2015 ■ 2016

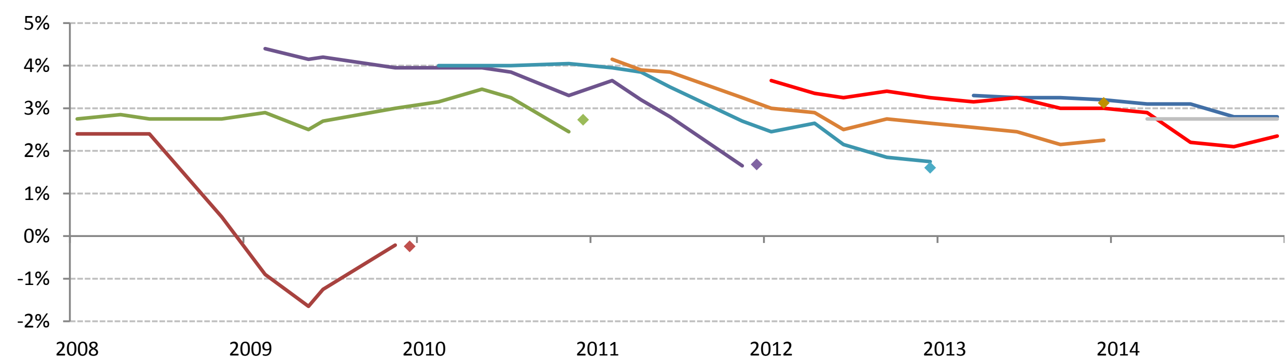
Unemployment



Core PCE inflation



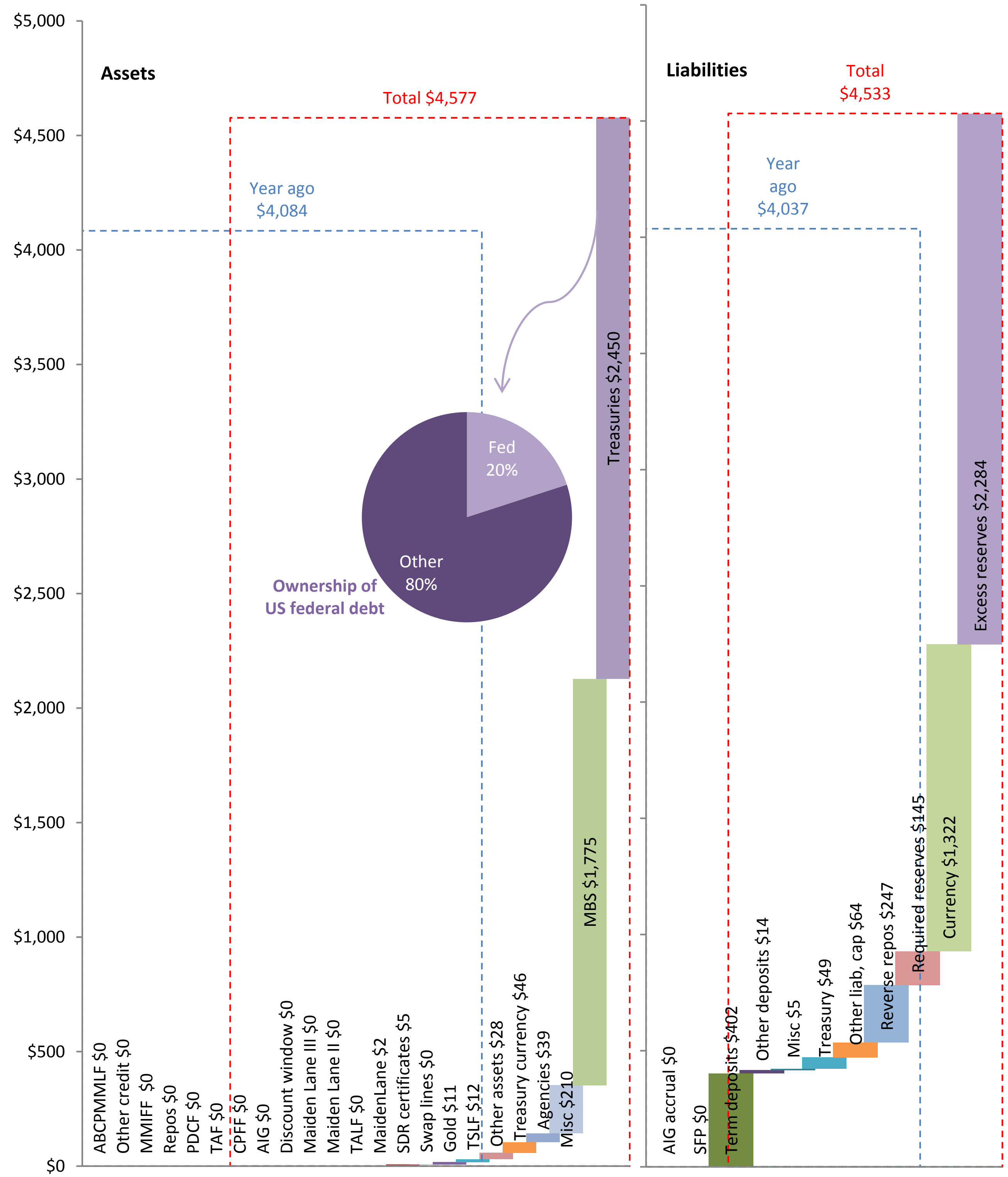
Real GDP



Source: Federal Reserve, BEA, BLS, TrendMacro calculations

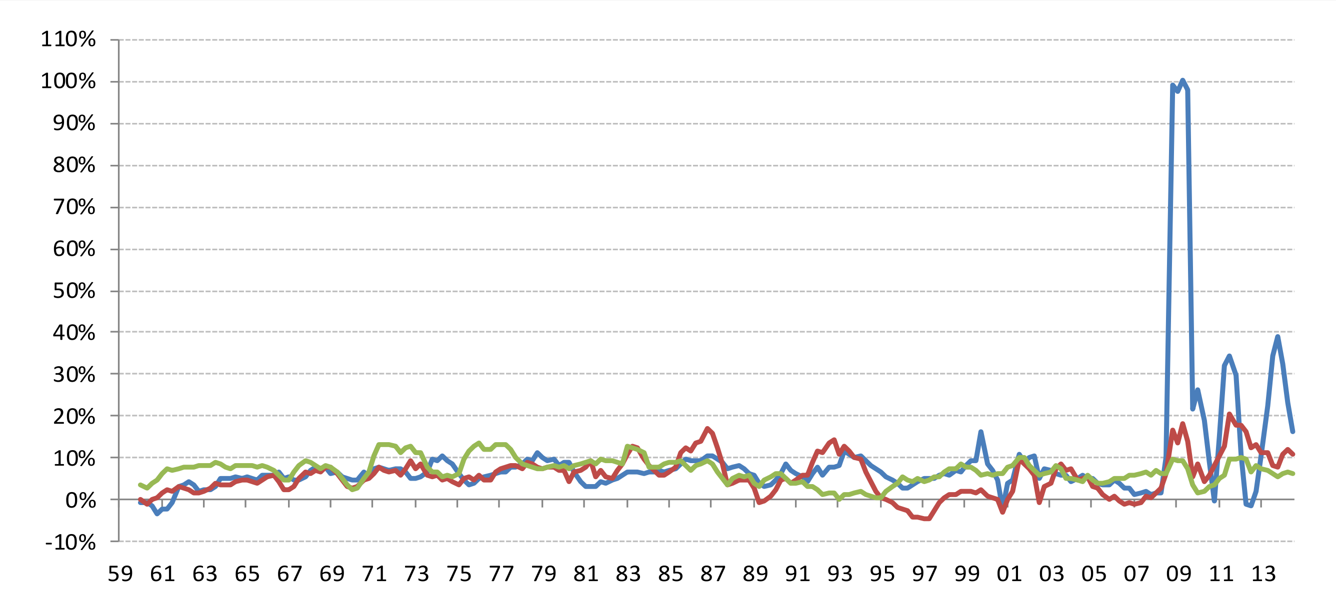
The Fed's assets, and how they are funded (USD billions)

Assets do not perfectly match liabilities because we include unsettled MBS purchases and sales



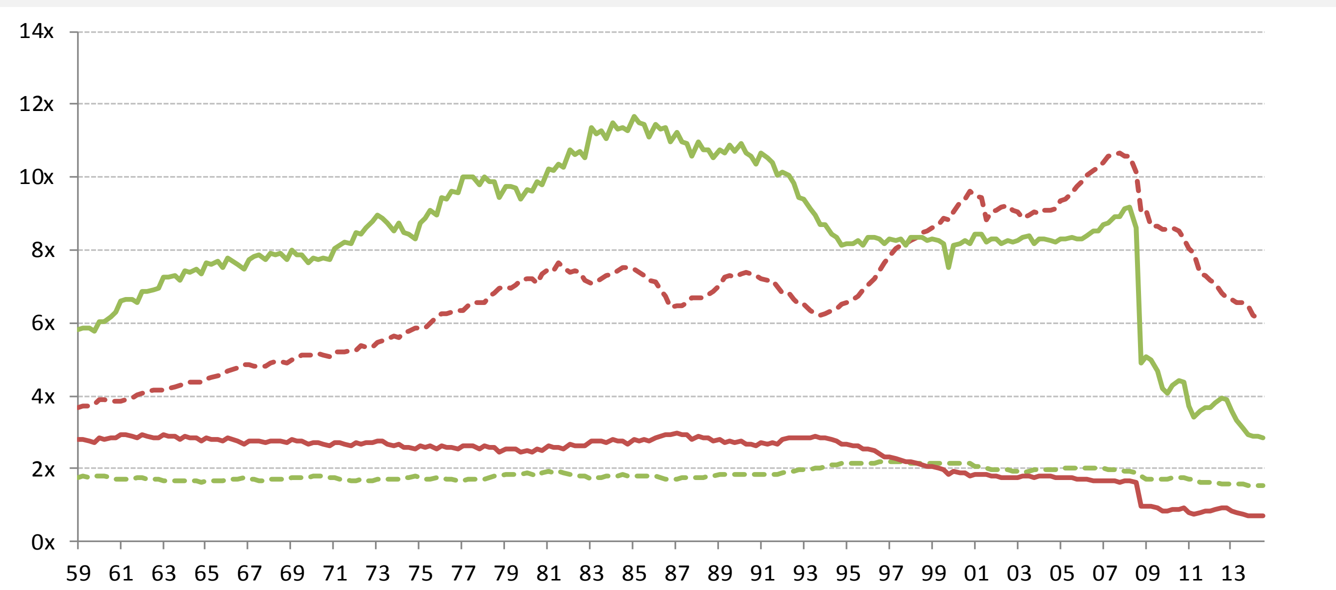
Source: Federal Reserve H.4, US Treasury, TrendMacro calculations

Money supply growth, YOY quarterly



Source: Federal Reserve H.6, TrendMacro calculations

Monetary velocity, quarterly



Source: BEA, Federal Reserve H.6, TrendMacro calculations