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Data Insights: Federal Reserve

Wednesday, December 14, 2016

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

Release Date: ~~November 2~~December 14, 2016

For release at 2:00 p.m. ~~EDT~~EST

Information received since the Federal Open Market Committee met in ~~September~~November indicates that the labor market has continued to strengthen and ~~growth of~~that economic activity has ~~picked up from the modest~~been expanding at a moderate pace ~~seen in the first half of this~~ since mid-year. ~~Although~~Job gains have been solid in recent months and the unemployment rate ~~is little changed in recent months, job gains have been solid~~has declined. Household spending has been rising moderately but business fixed investment has remained soft. Inflation has increased ~~somewhat~~ since earlier this year but is still below the Committee's 2 percent longer-run objective, partly reflecting earlier declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation have moved up considerably but ~~remain~~still are low; most survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace and labor market conditions will strengthen somewhat further. Inflation is expected to rise to 2 percent over the medium term as the transitory effects of past declines in energy and import prices dissipate and the labor market strengthens further. Near-term risks to the economic outlook appear roughly balanced. The Committee continues to closely monitor inflation indicators and global economic and financial developments.

~~Against this backdrop~~In view of realized and expected labor market conditions and inflation, the Committee decided to ~~maintain~~raise the target range for the federal funds rate ~~at 1/4~~ to 1/2 to 3/4 percent. ~~The Committee judges that the case for an increase in the federal funds rate has continued to strengthen but decided, for the time being, to wait for some further evidence of continued progress toward its objectives.~~ The stance of monetary policy remains accommodative, thereby supporting some further ~~improvement~~strengthening in labor market conditions and a return to 2 percent inflation.

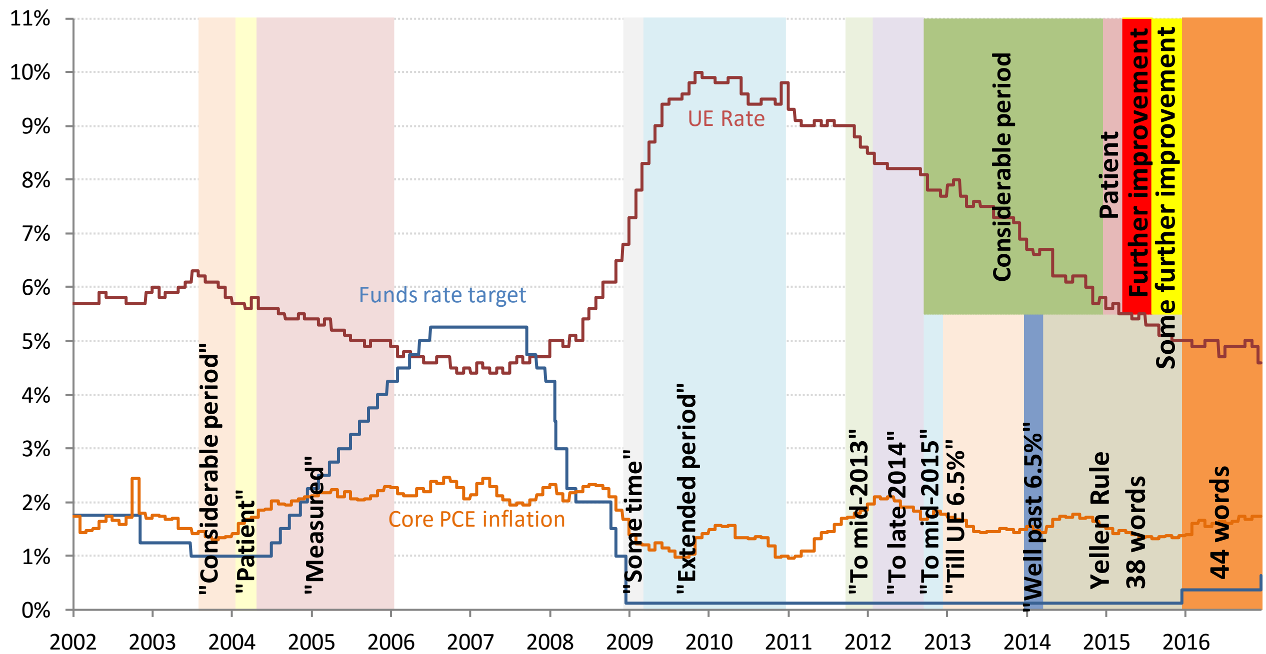
In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. In light of the current shortfall of inflation from 2 percent, the Committee will carefully monitor actual and expected progress toward its inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.

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, and it anticipates doing so until normalization of the level of the federal funds rate is well under way. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; James Bullard; Stanley Fischer; Esther L. George; Loretta J. Mester; Jerome H. Powell; Eric Rosengren; and Daniel K. Tarullo~~. Voting against the action were: Esther L. George and Loretta J. Mester, each of whom preferred at this meeting to raise the target range for the federal funds rate to 1/2 to 3/4 percent~~.

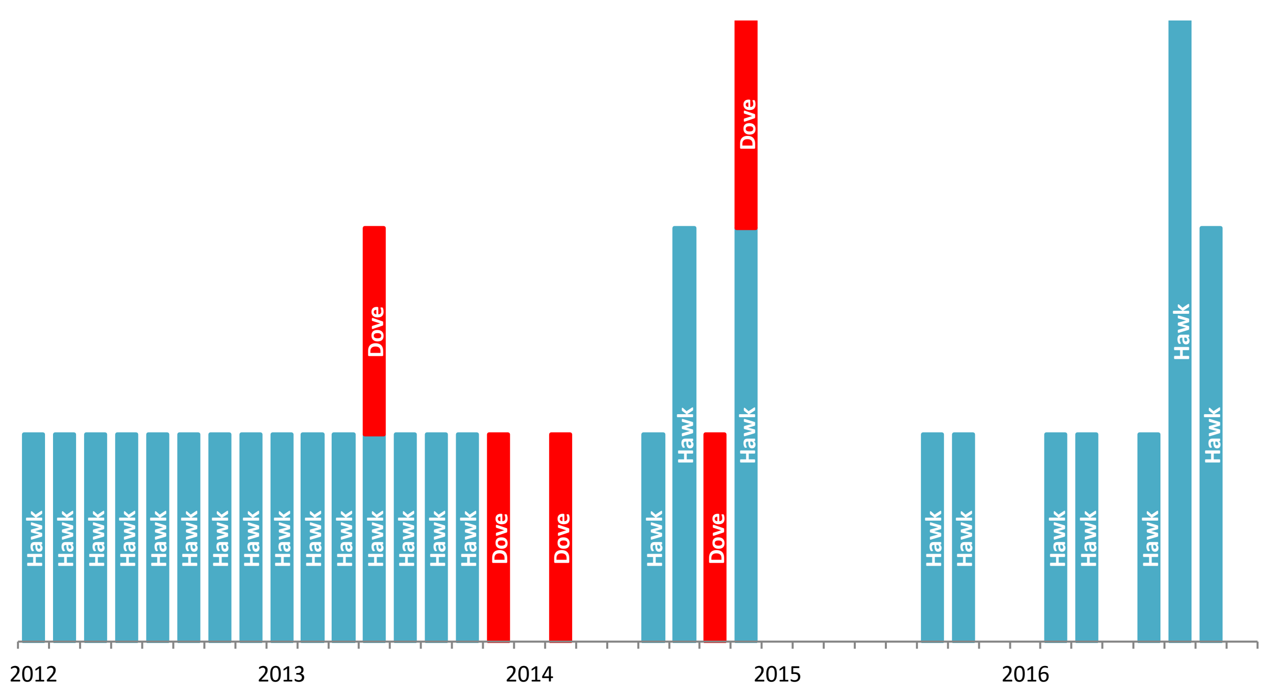
Source: FOMC, TrendMacro analysis

Fedspeak regime change: the evolution of forward guidance



Source: FOMC, Federal Reserve, BLS, BEA, TrendMacro calculations

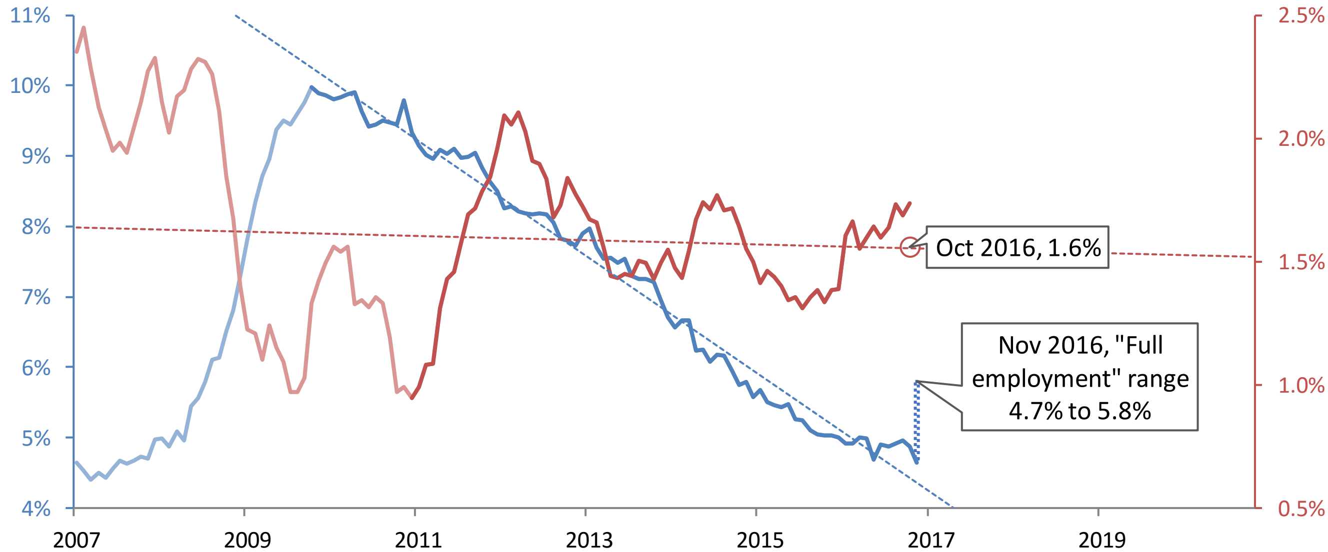
Other voices: number and direction of FOMC decision dissents



Source: FOMC, TrendMacro calculations

The dual mandate: garbage in, garbage out

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

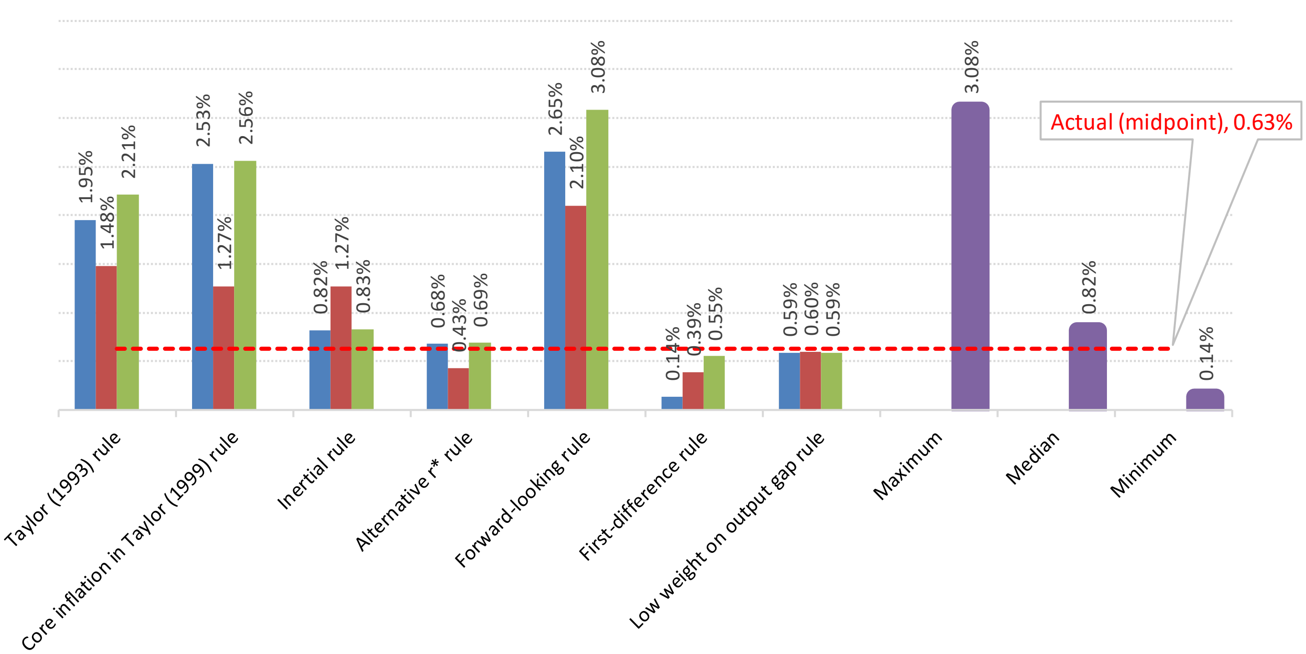


Source: BLS Current Population Survey, TrendMacro calculations

So many policy rules, so little time…

As of Q4-2016 Based on inputs from:

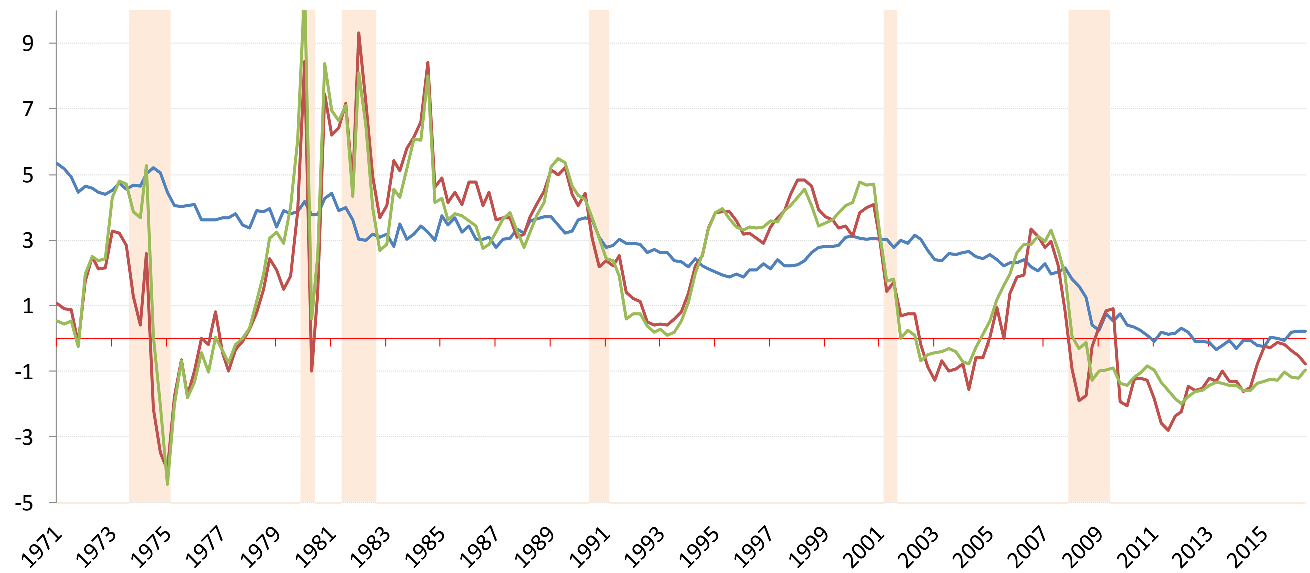
FOMC Summary of Economic Projections · Congressional Budget Office · Cleveland Fed



Source: Cleveland Fed, TrendMacro calculations

Estimating the "natural rate of interest"

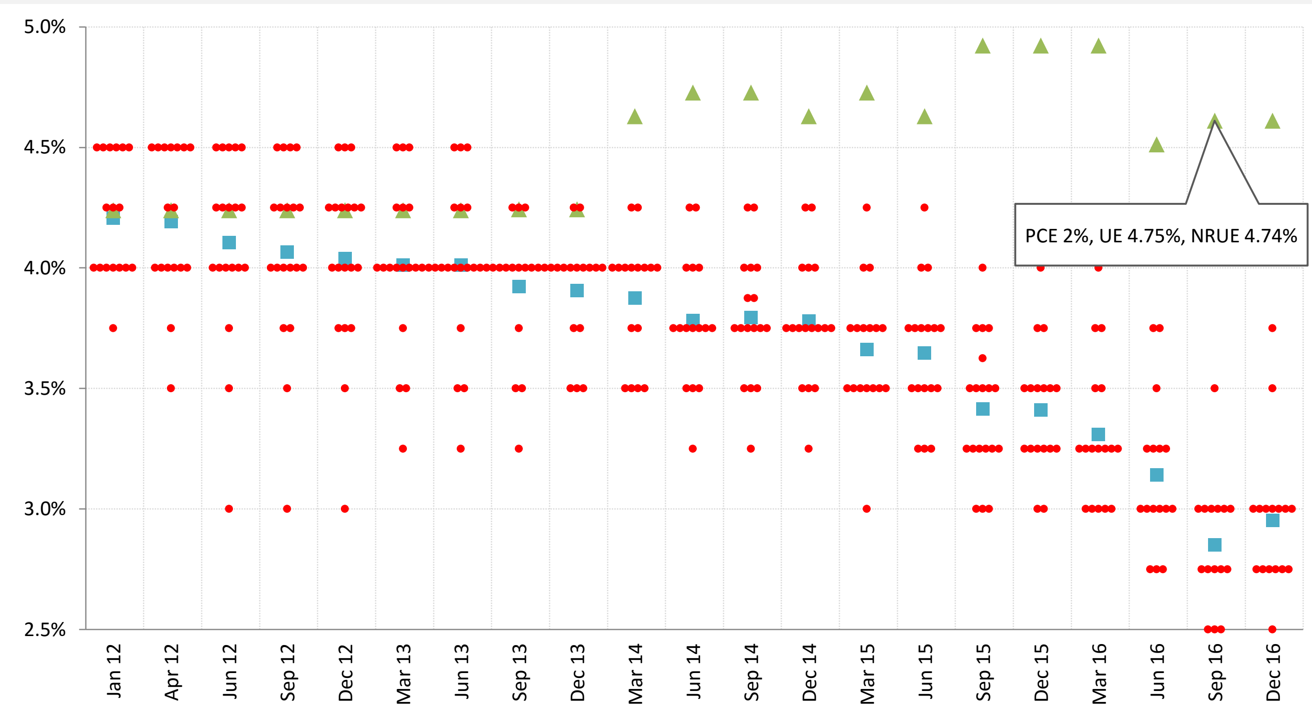
Neutral real funds rate — Actual real funds rate (headline PCE) — Actual (core) — Recession



Source: Laubach & Williams, Federal Reserve, BEA, TrendMacro calculations

"R-star" – the ultimate "dotplot"

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

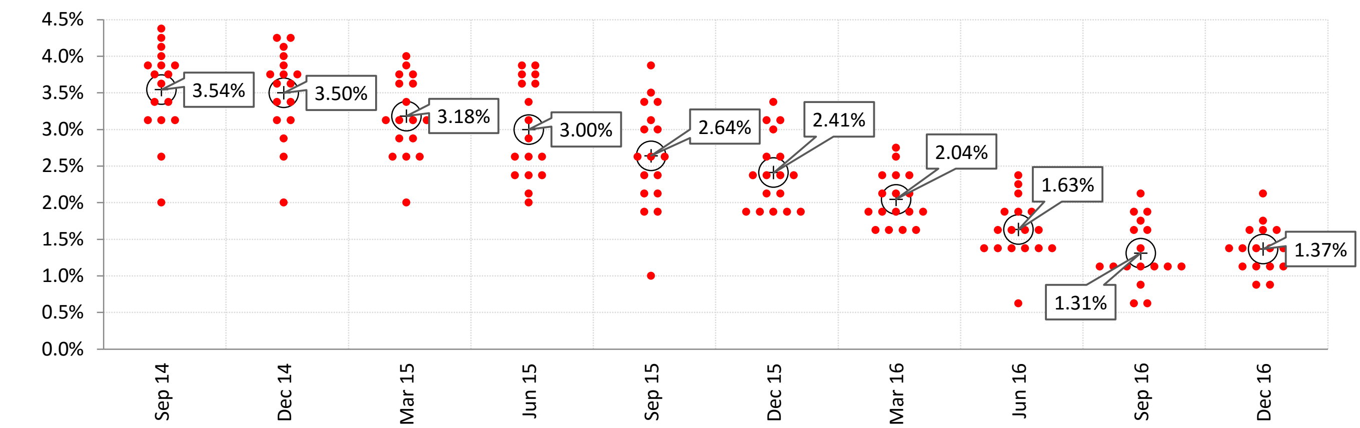


Source: Federal Reserve, TrendMacro calculations

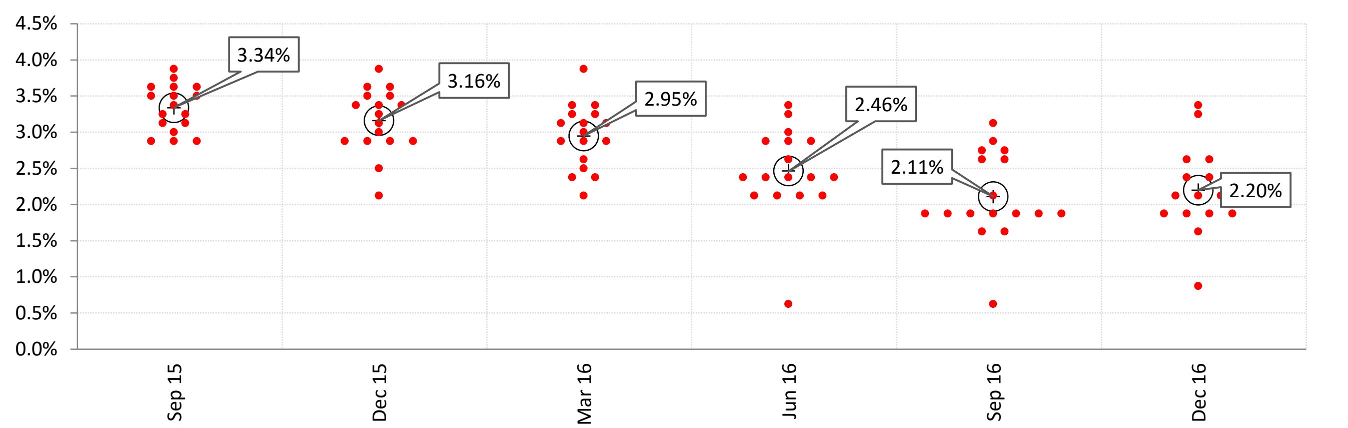
Tracking the "dotplots" year by year

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

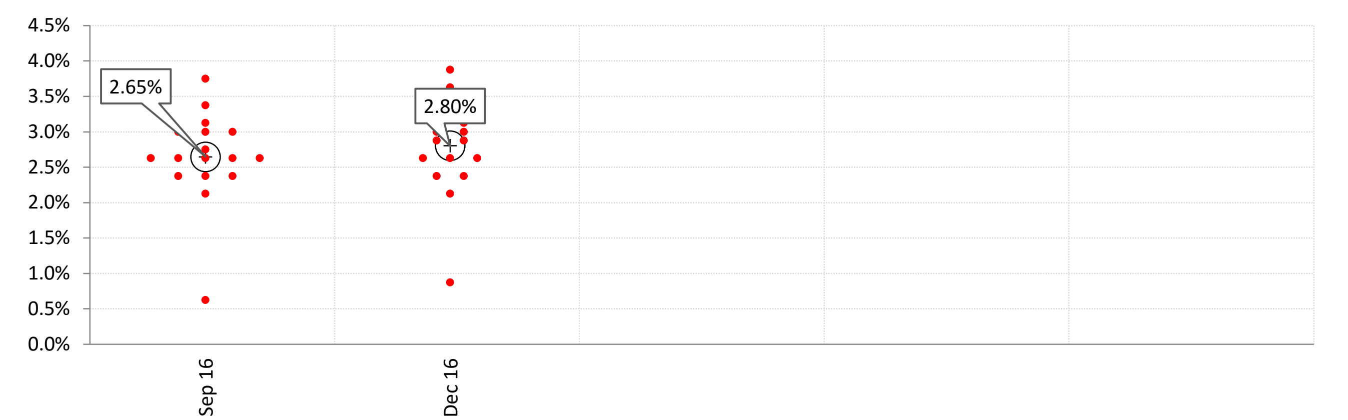
For year-end 2017



For year-end 2018



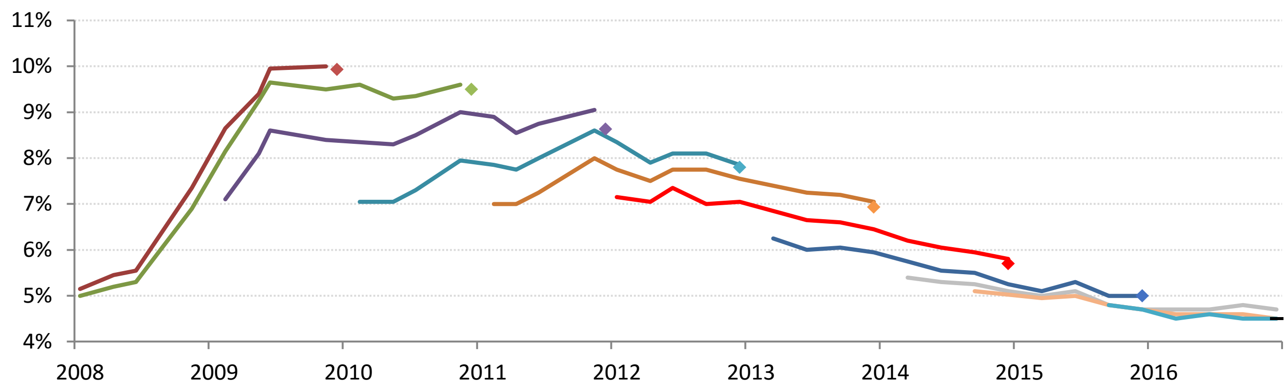
For year-end 2019



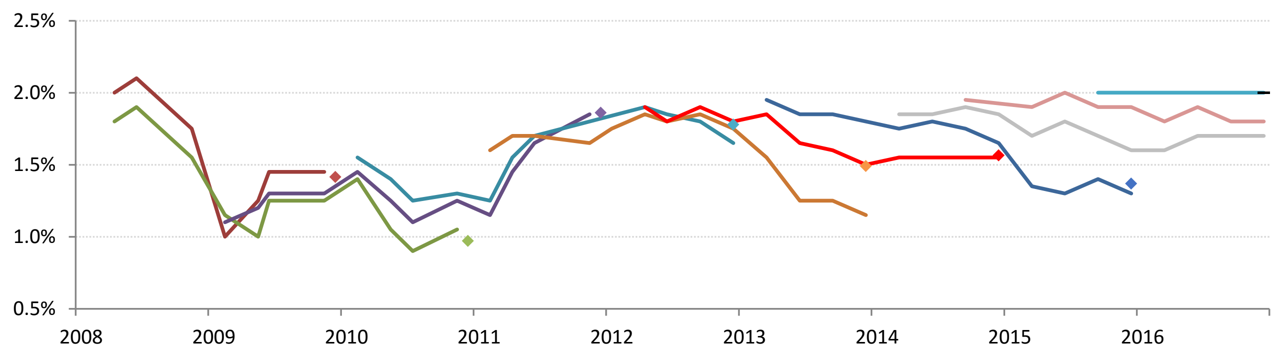
Forecast versus actual: economic projections of the FRB and the presidents

— Forecast ◆ Actual ■ 2009 ■ 10 ■ 11 ■ 12 ■ 13 ■ 14 ■ 15 ■ 16 ■ 17 ■ 18 ■ 2019

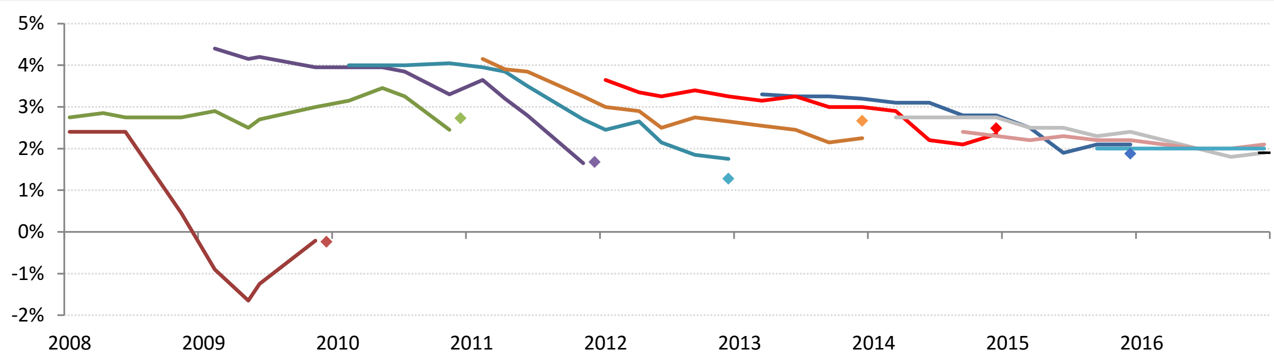
Unemployment



Core PCE inflation



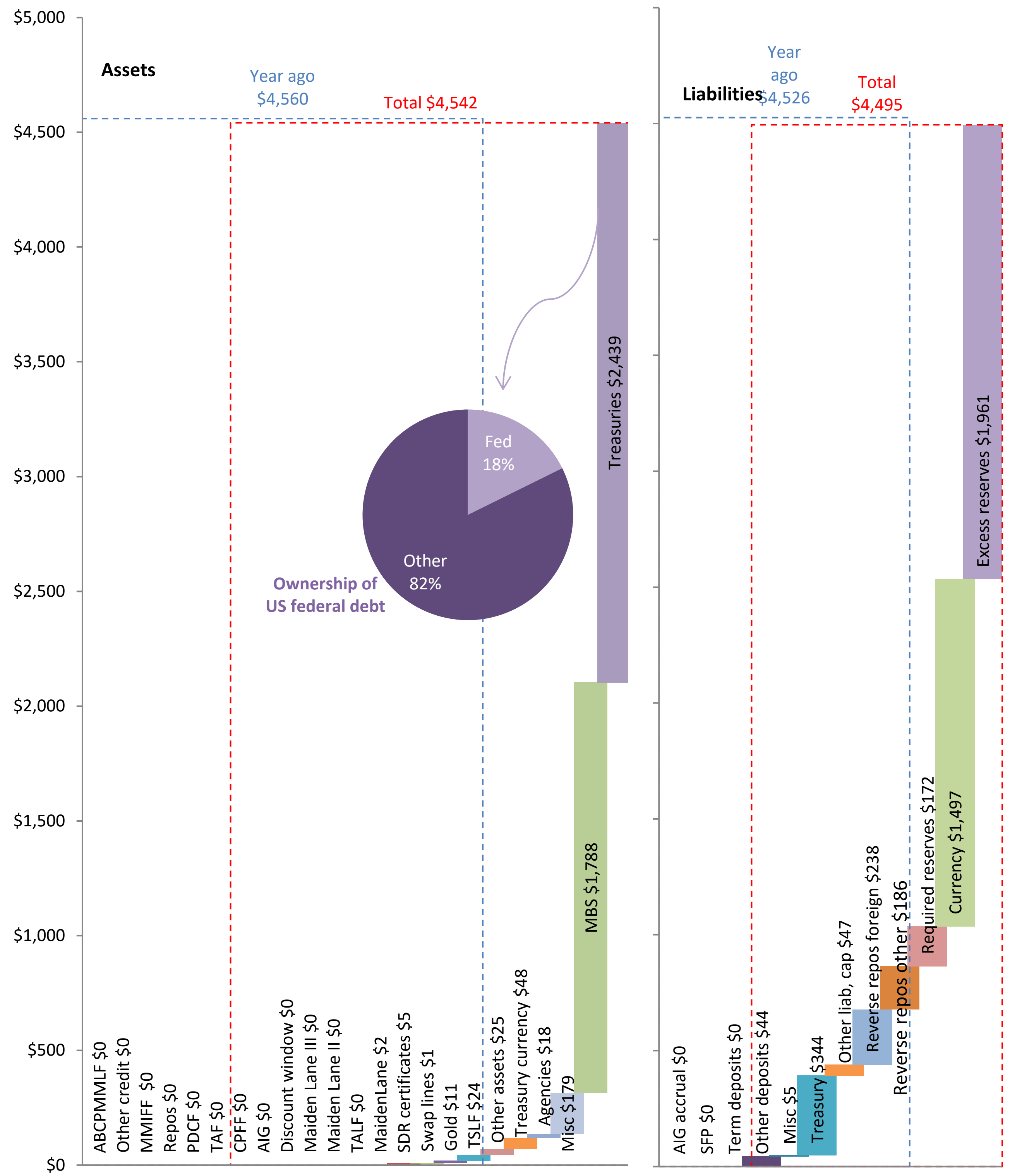
Real GDP



Source: Federal Reserve, BEA, BLS, TrendMacro calculations

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

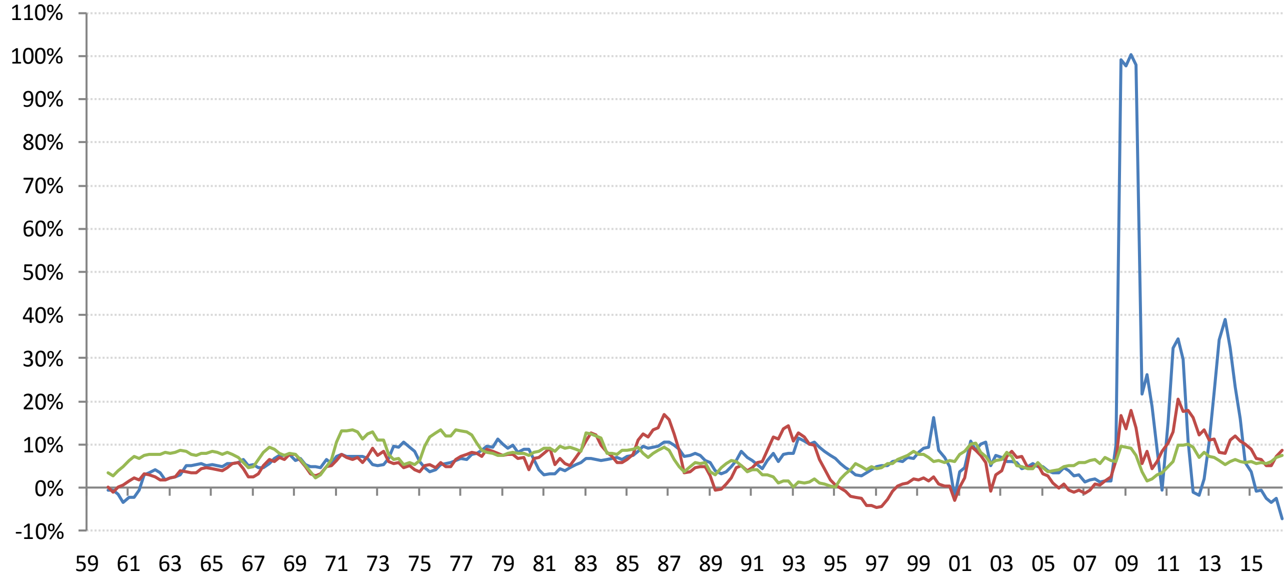
Assets do not perfectly match liabilities because we include unsettled MBS purchases and sales



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

Money supply growth, YOY quarterly

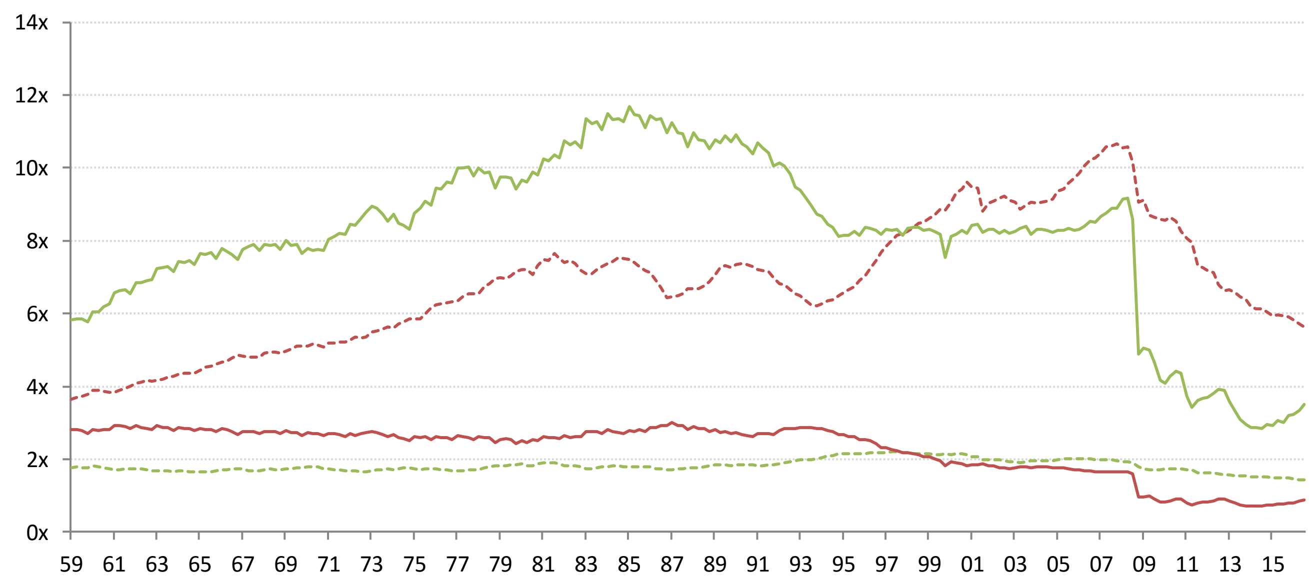
M1 — M2 — Monetary base



Source: Federal Reserve H.6, TrendMacro calculations

Monetary velocity, quarterly

M1 base multiplier ---- M1 output multiplier — M2 base multiplier ---- M2 output multiplier



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