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Data Insights: Federal Reserve

Wednesday, June 14, 2017

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

~~May 03~~June 14, 2017

Information received since the Federal Open Market Committee met in ~~March~~May indicates that the labor market has continued to strengthen ~~even as growth in~~and that economic activity ~~slowed.~~has been rising moderately so far this year. Job gains ~~were~~have moderated but have been solid, on average, ~~in recent months~~since the beginning of the year, and the unemployment rate has declined. Household spending ~~rose only modestly, but the fundamentals underpinning the continued growth of consumption remained solid. Business~~has picked up in recent months, and business fixed investment ~~firmed. Inflation measured on~~has continued to expand. On a 12-month basis ~~recently has been running close to the Committee's 2 percent longer-run objective. Excluding energy and food, consumer prices declined in March and~~, inflation ~~continued to run~~has declined recently and, like the measure excluding food and energy prices, is running somewhat below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. ~~The Committee views the slowing in growth during the first quarter as likely to be transitory and~~The Committee continues to expect 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~~, and inflation will~~ . Inflation on a 12-month basis is expected to remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term. Near~~-~~ term risks to the economic outlook appear roughly balanced~~. The~~, but the Committee ~~continues to closely monitor inflation indicators and global economic and financial~~ is monitoring inflation developments closely.

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 3/4~~ to 1 to 1-1/4 percent. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained 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. The Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant 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~~. The Committee currently expects to begin implementing a balance sheet normalization program this year, provided that the economy evolves broadly as anticipated. This program, which would gradually reduce the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities, is described in the accompanying addendum to the Committee's Policy Normalization Principles and Plans.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Charles L. Evans; Stanley Fischer; Patrick Harker; Robert S. Kaplan; ~~Neel Kashkari;~~ and Jerome H. Powell. Voting against the action was Neel Kashkari, who preferred at this meeting to maintain the existing target range for the federal funds rate.

FOMC issues addendum to the Policy Normalization Principles and Plans

Addendum to the Policy Normalization Principles and Plans

All participants agreed to augment the Committee's Policy Normalization Principles and Plans by providing the following additional details regarding the approach the FOMC intends to use to reduce the Federal Reserve's holdings of Treasury and agency securities once normalization of the level of the federal funds rate is well under way.[1]

- The Committee intends to gradually reduce the Federal Reserve's securities holdings by decreasing its reinvestment of the principal payments it receives from securities held in the System Open Market Account. Specifically, such payments will be reinvested only to the extent that they exceed gradually rising caps.
    - For payments of principal that the Federal Reserve receives from maturing Treasury securities, the Committee anticipates that the cap will be $6 billion per month initially and will increase in steps of $6 billion at three-month intervals over 12 months until it reaches $30 billion per month.
    - For payments of principal that the Federal Reserve receives from its holdings of agency debt and mortgage-backed securities, the Committee anticipates that the cap will be $4 billion per month initially and will increase in steps of $4 billion at three-month intervals over 12 months until it reaches $20 billion per month.
    - The Committee also anticipates that the caps will remain in place once they reach their respective maximums so that the Federal Reserve's securities holdings will continue to decline in a gradual and predictable manner until the Committee judges that the Federal Reserve is holding no more securities than necessary to implement monetary policy efficiently and effectively.

- Gradually reducing the Federal Reserve's securities holdings will result in a declining supply of reserve balances. The Committee currently anticipates reducing the quantity of reserve balances, over time, to a level appreciably below that seen in recent years but larger than before the financial crisis; the level will reflect the banking system's demand for reserve balances and the Committee's decisions about how to implement monetary policy most efficiently and effectively in the future. The Committee expects to learn more about the underlying demand for reserves during the process of balance sheet normalization.
- The Committee affirms that changing the target range for the federal funds rate is its primary means of adjusting the stance of monetary policy. However, the Committee would be prepared to resume reinvestment of principal payments received on securities held by the Federal Reserve if a material deterioration in the economic outlook were to warrant a sizable reduction in the Committee's target for the federal funds rate. Moreover, the Committee would be prepared to use its full range of tools, including altering the size and composition of its balance sheet, if future economic conditions were to warrant a more accommodative monetary policy than can be achieved solely by reducing the federal funds rate.

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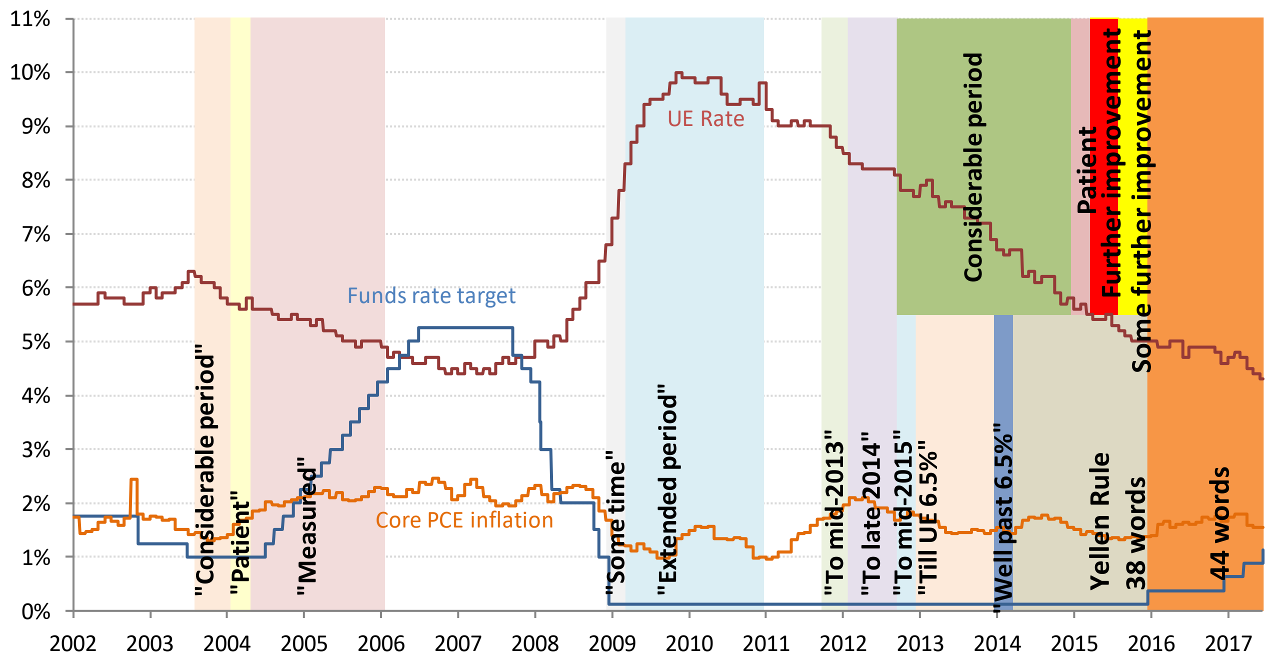
1. The Committee's Policy Normalization Principles and Plans were adopted on September 16, 2014, and are available at www.federalreserve.gov/monetarypolicy/files/FOMC_PolicyNormalization.pdf. On March 18, 2015, the Committee adopted an addendum to the Policy Normalization Principles and Plans, which is available at www.federalreserve.gov/monetarypolicy/files/FOMC_PolicyNormalization.20150318.pdf. Return to text

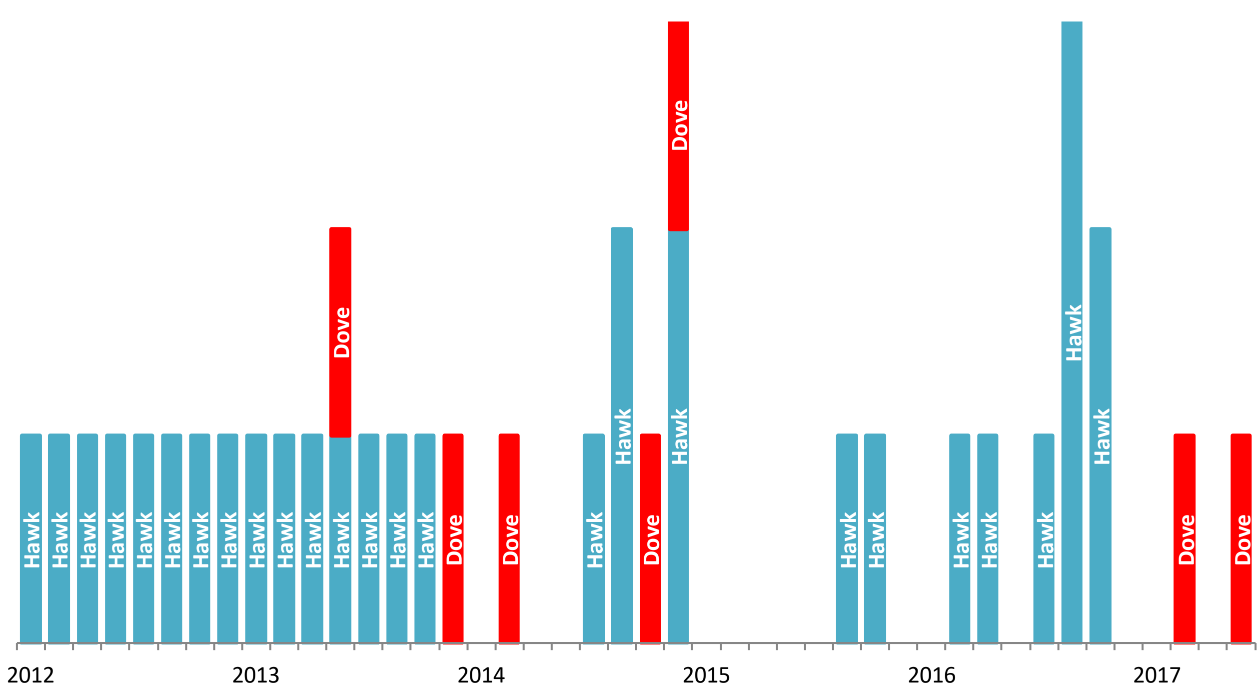
Source: FOMC, TrendMacro analysis

Fedspeak regime change: the evolution of forward guidance



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

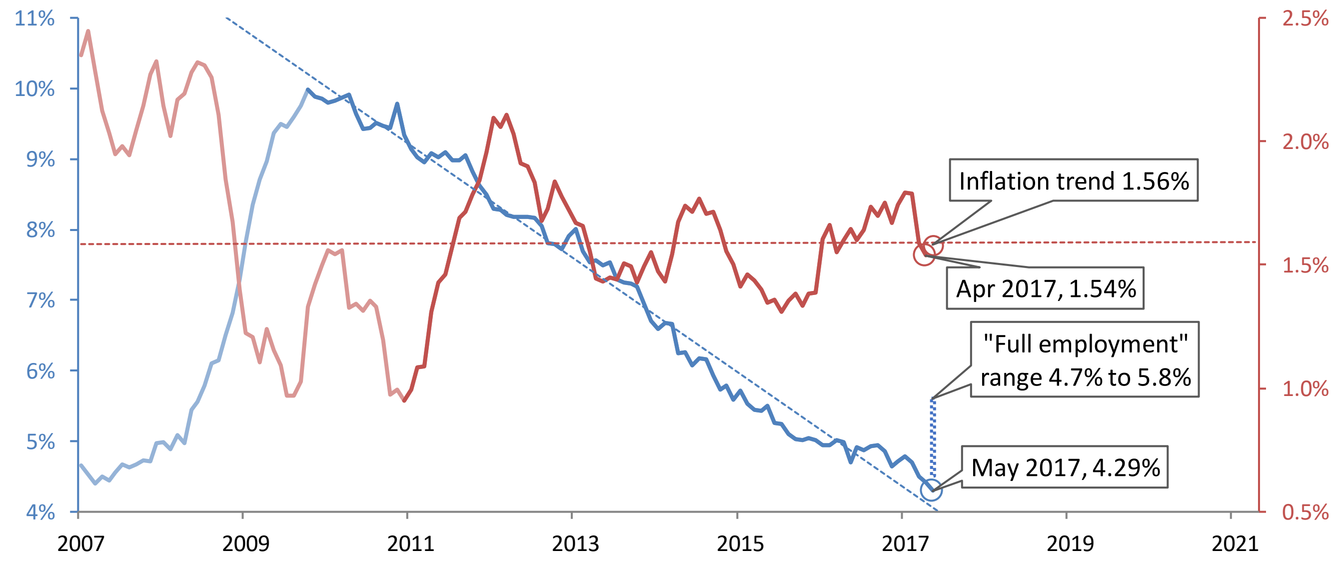
Other voices: number and direction of FOMC decision dissents



Source: FOMC, TrendMacro calculations

The dual mandate: garbage in, garbage out

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

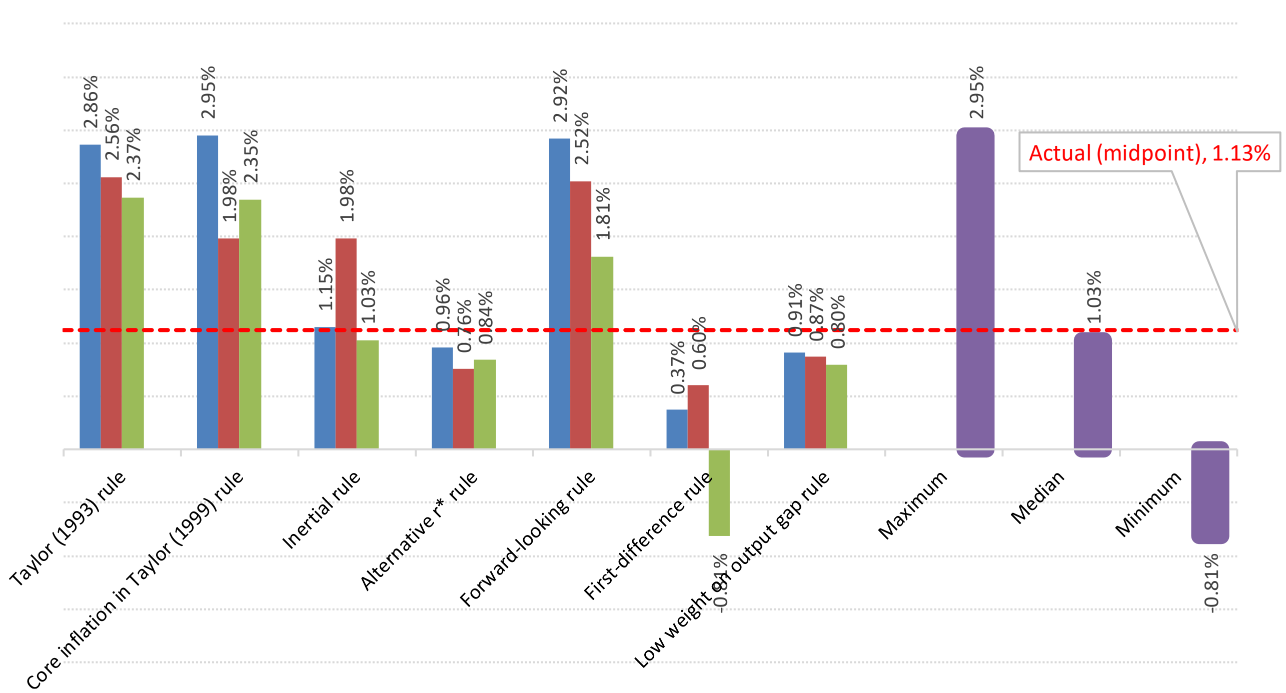


Source: BLS Current Population Survey, TrendMacro calculations

So many policy rules, so little time…

As of February 16, 2017 Based on inputs from:

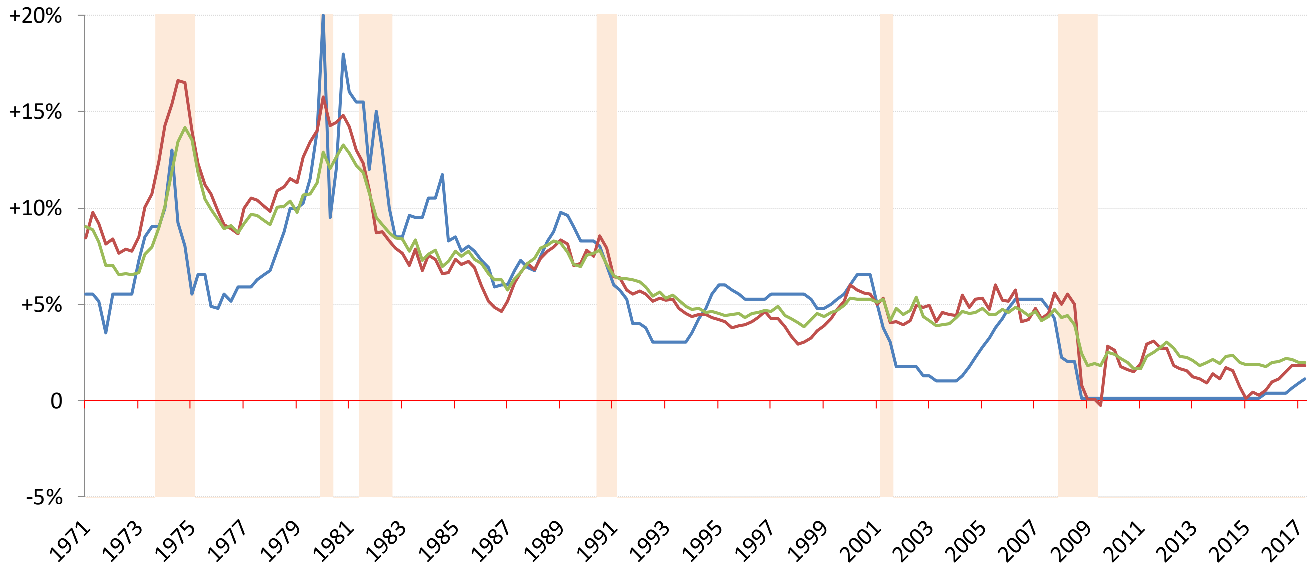
FOMC Summary of Economic Projections — Congressional Budget Office — Cleveland Fed



Source: Cleveland Fed, TrendMacro calculations

Estimating the “natural rate of interest”

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

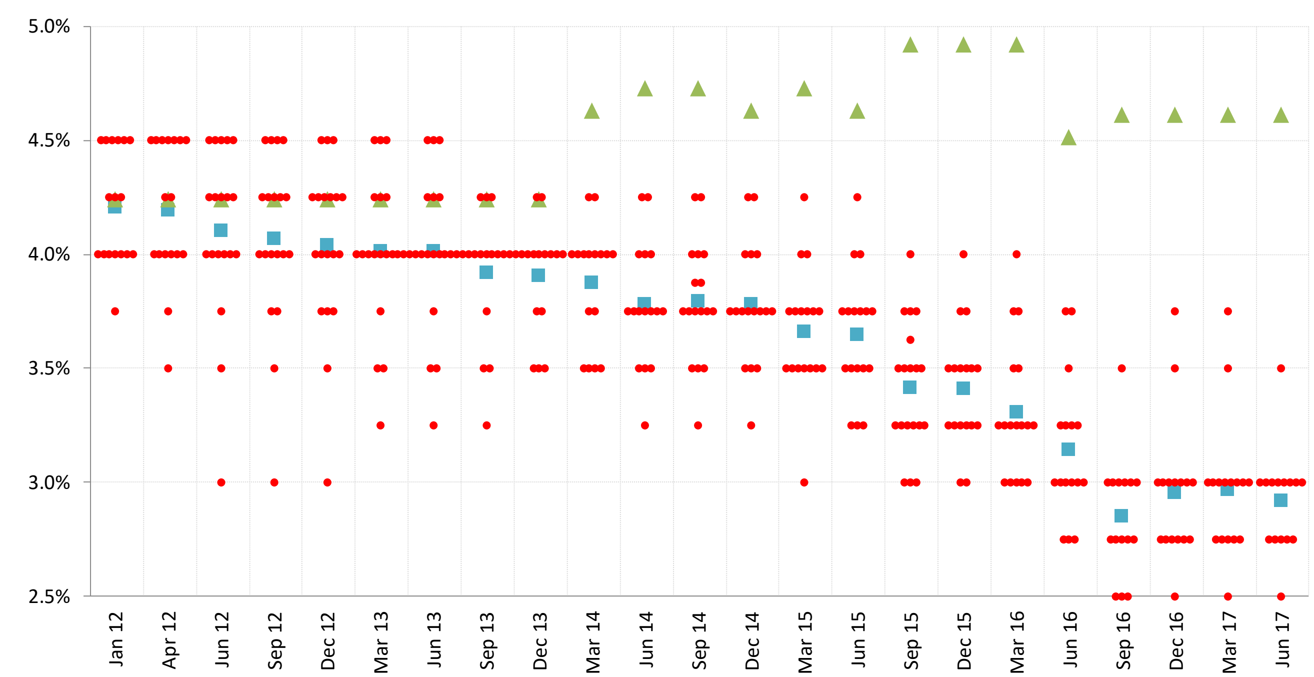


Source: Laubach & Williams, Federal Reserve, BEA, TrendMacro calculations

“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

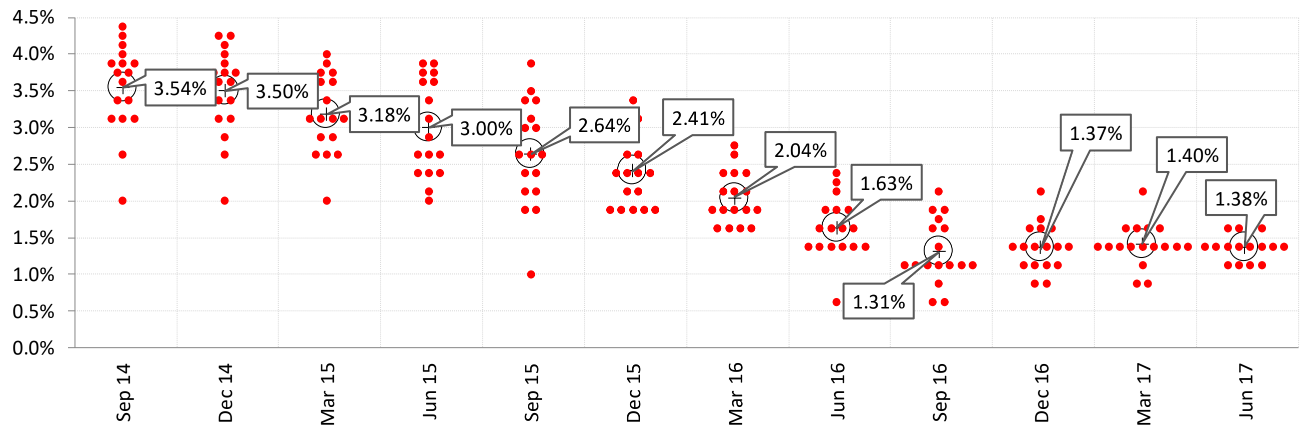


Source: Federal Reserve, TrendMacro calculations

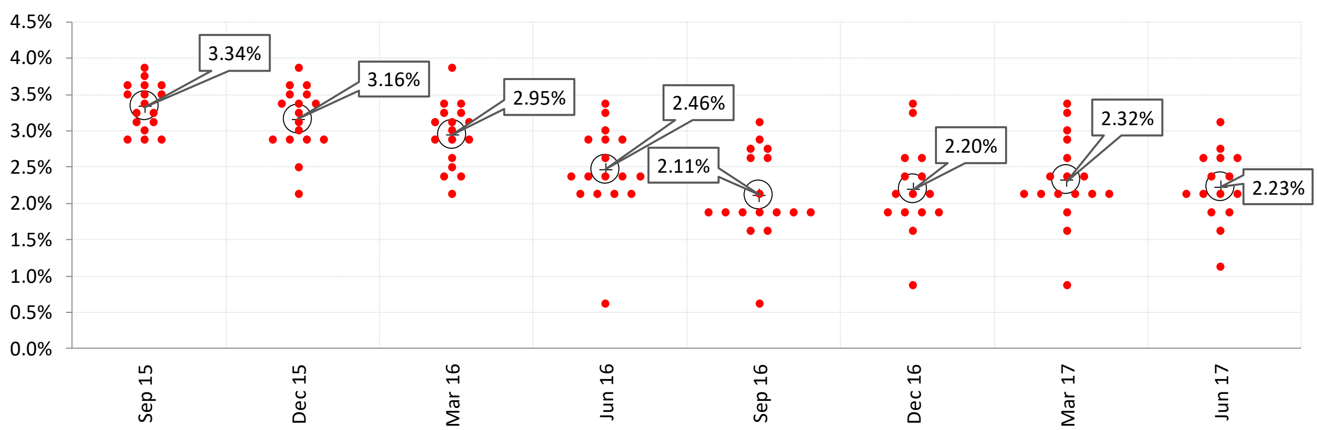
Tracking the "dotplots" year by year

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

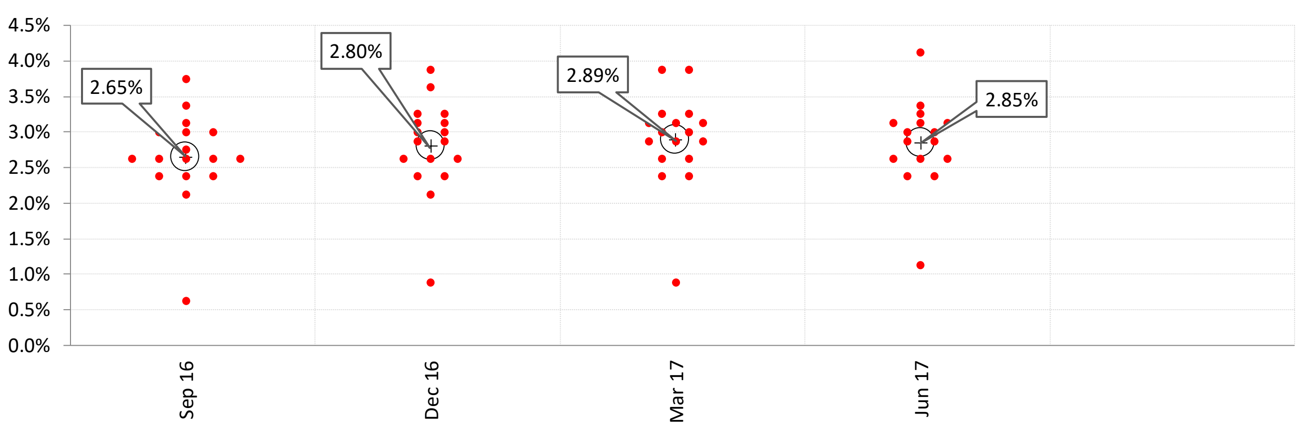
For year-end 2017



For year-end 2018



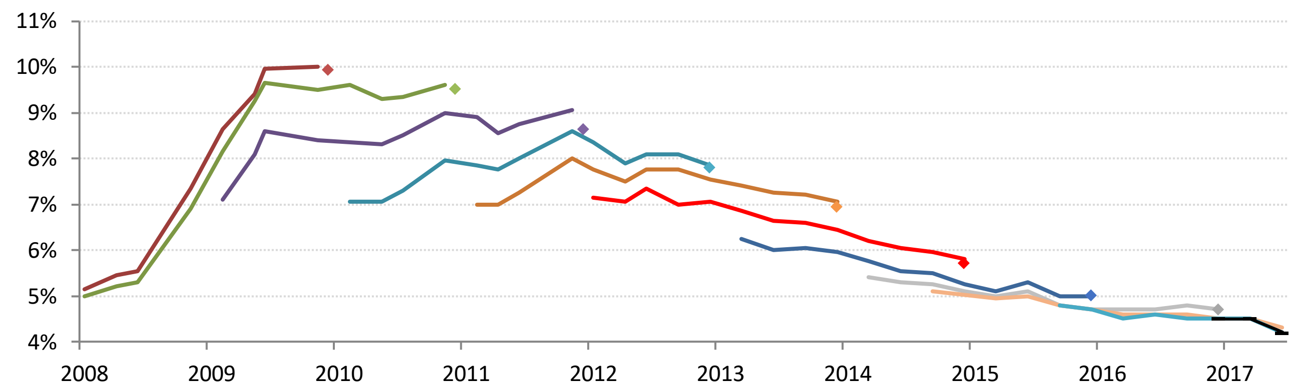
For year-end 2019



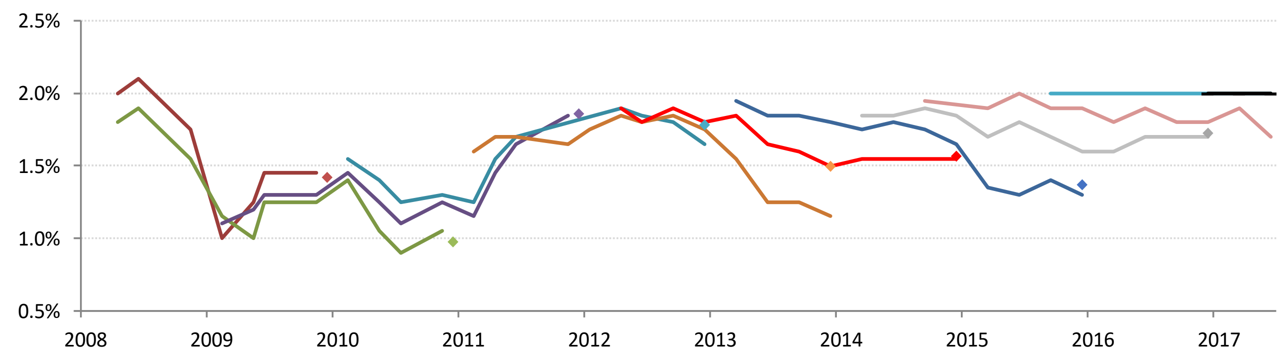
Forecast versus actual: economic projections of the FRB and the presidents

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

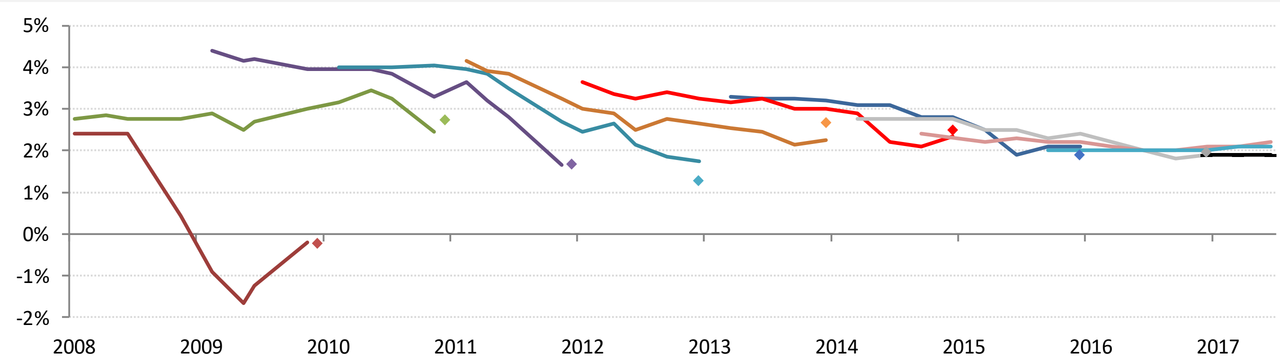
Unemployment



Core PCE inflation



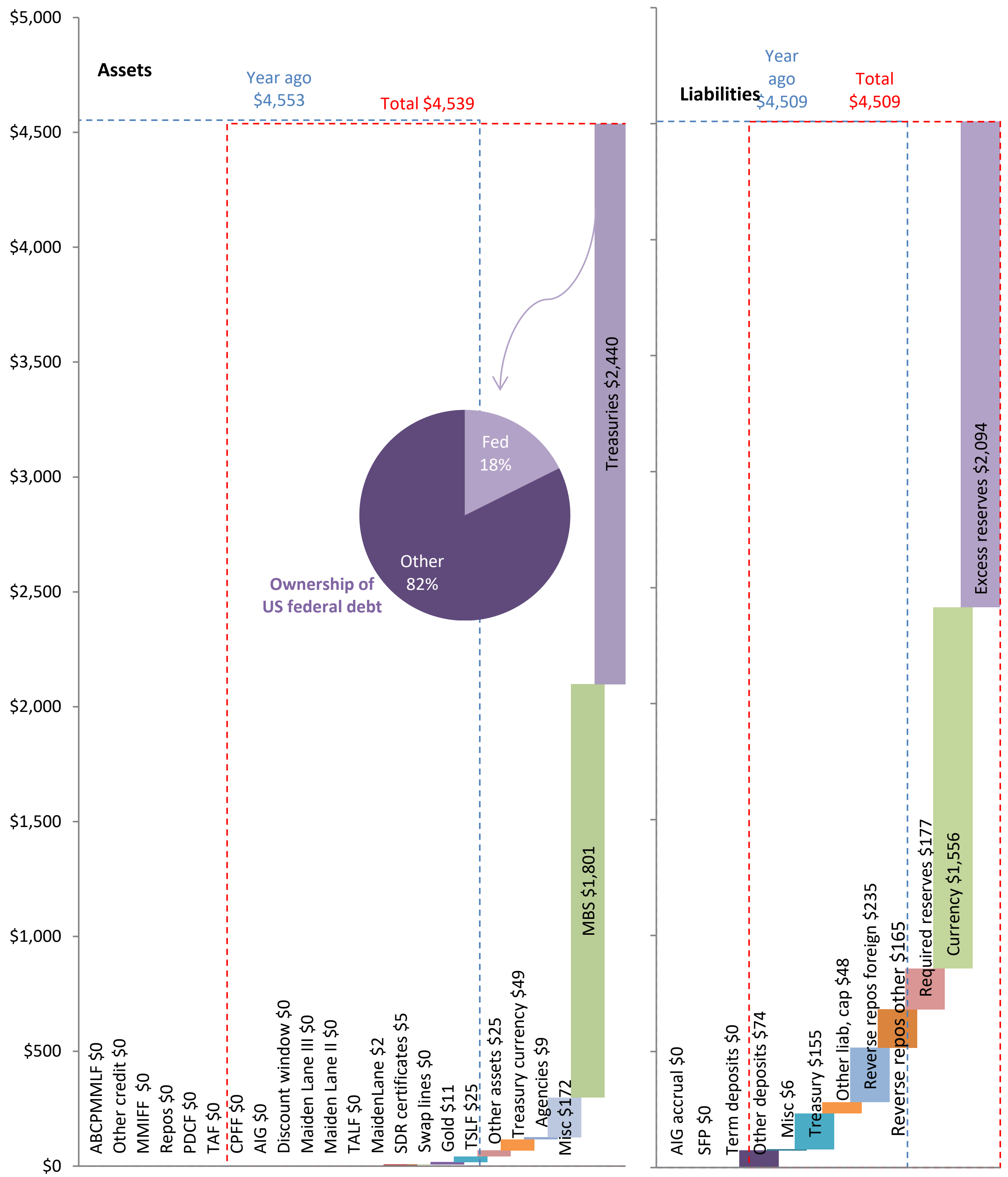
Real GDP



Source: Federal Reserve, BEA, BLS, TrendMacro calculations

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

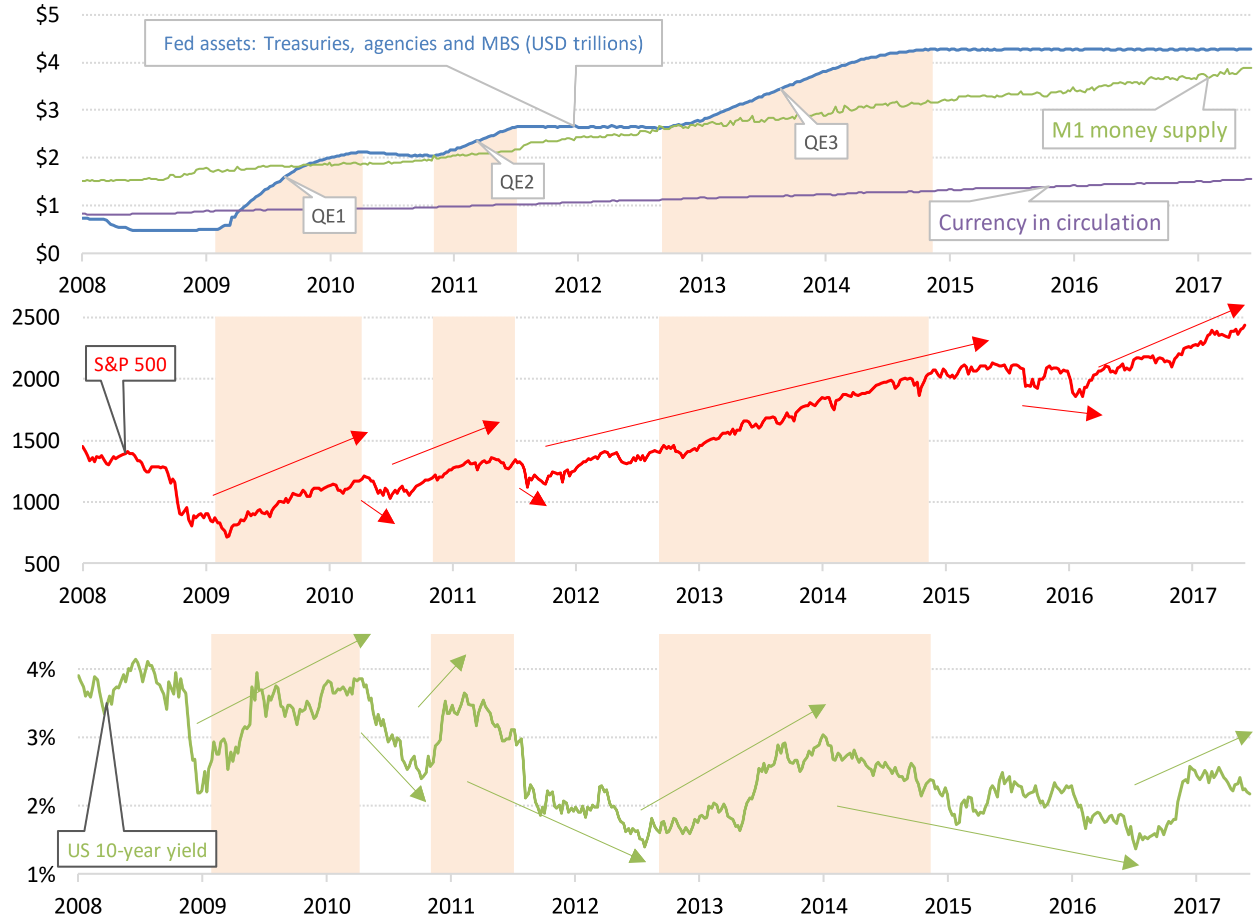
Assets do not perfectly match liabilities because we include unsettled MBS purchases and sales



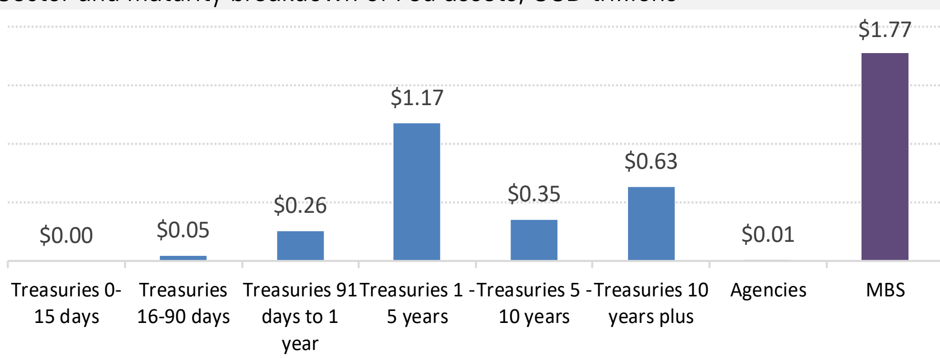
Source: Federal Reserve H.4, US Treasury, TrendMacro calculations

The Fed's asset purchases, and their effects on markets

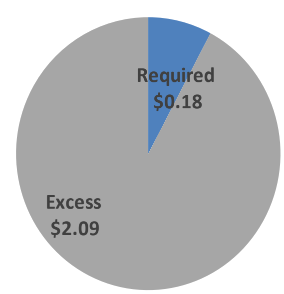
Stocks and bond yields react to changes in Fed Treasury, agency and MBS holdings



Sector and maturity breakdown of Fed assets, USD trillions

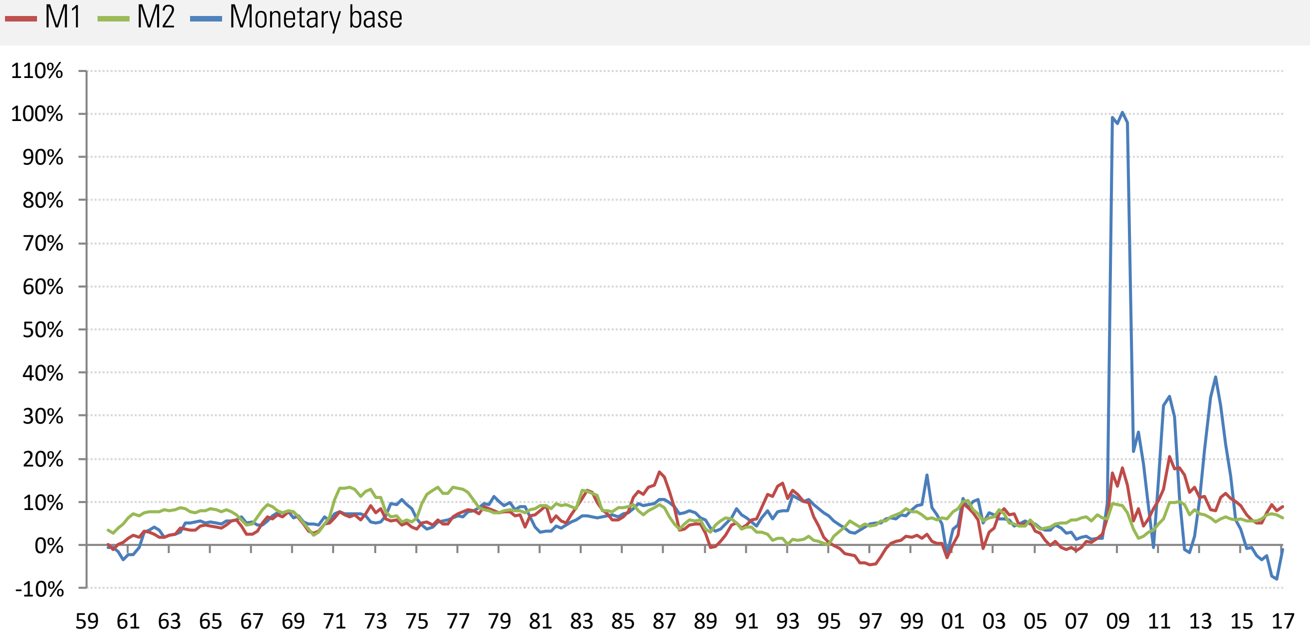


Banking reserves, USD trillions



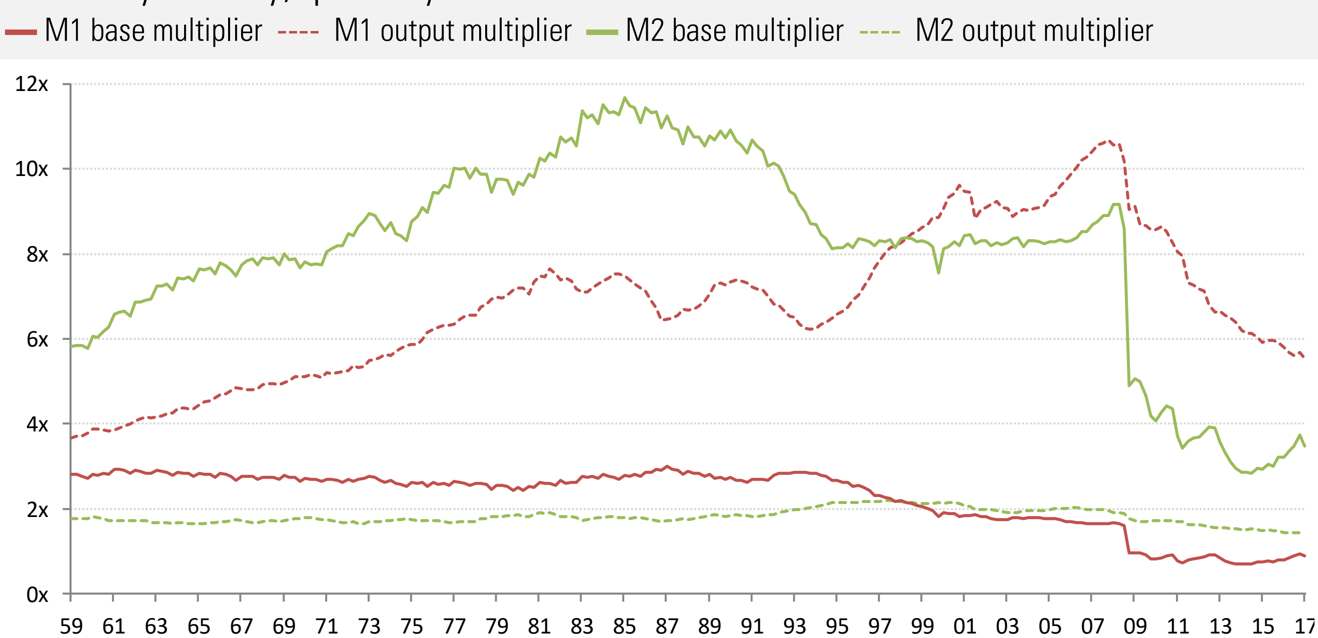
Source: Federal Reserve, Bloomberg, TrendMacro calculations

Money supply growth, YOY quarterly



Source: Federal Reserve H.6, TrendMacro calculations

Monetary velocity, quarterly



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