ECONOMIC UPDATE

REGIONS

January 27, 2016

January 2016 FOMC Meeting: FOMC Steps Back For A Closer Look

- The FOMC left the Fed funds rate target range unchanged, with the mid-point remaining at 0.375 percent.
- The post-meeting policy statement suggests concerns over global developments and challenges to the inflation outlook.

To the surprise of absolutely no one, the FOMC left the Fed funds rate target range unchanged at the conclusion of their two-day meeting. The only real mystery heading into the meeting was whether, or to what extent, the post-meeting policy statement would be altered and whether any such alterations would sway expectations for the path of the funds rate over the remainder of 2016. In our view, the Committee kept their options open while acknowledging challenges on the domestic and global fronts. There were no dissenting votes amongst the new voting bloc of the broader Committee.

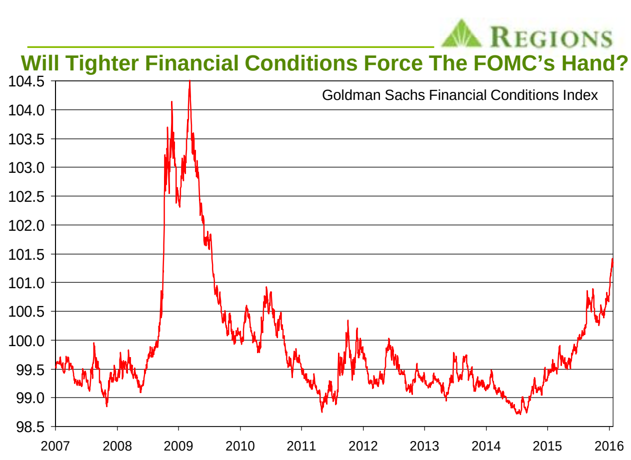
In their assessment of current economic conditions the Committee noted economic growth slowed late last year. After having characterized growth in household and business spending as "solid" in their December statement, the Committee characterized such growth as "moderate" in today's statement. The references to further improvement in the housing sector and soft net exports were unchanged from December, but in today's statement the Committee explicitly noted that inventory investment had slowed. This slower pace of inventory investment is the biggest factor behind expectations that annualized real GDP growth slowed to less than one percent in Q4 2015 (the first estimate will be released 1/29, our forecast is for growth of 0.9 percent).

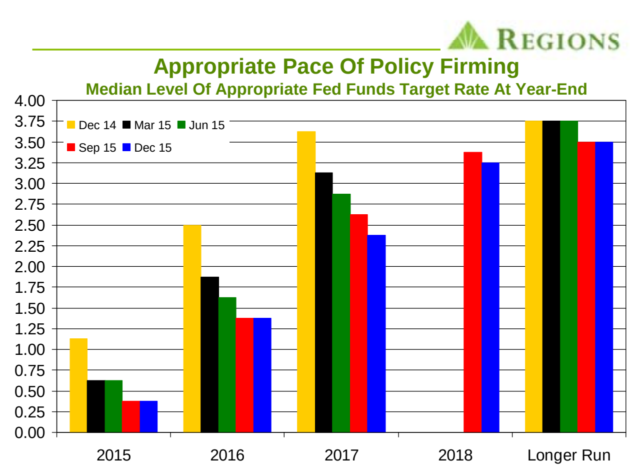
The discussion of inflation was much the same as in December, with declines in energy and import prices the primary factors behind inflation lagging significantly behind the 2.0 percent target rate. But, the Committee did make note of further declines in market-based measures of inflation compensation, which in the December statement were characterized as "remaining low." The Committee once again noted the expectation that inflation would rise to 2.0 percent over the medium term as "transitory" effects of declining prices for energy as well as non-energy imports fade and the labor market strengthens further. But, today's statement notes inflation is 'expected to remain low in the near term," which is a new addition. More significantly, the passage in the December statement that the Committee is "reasonably confident that inflation will rise, over the medium term, to its 2 percent objective" is conspicuously absent from today's statement.

Another notable change in the post-meeting statement pertains to the balance of risks between growth and inflation. In the December statement the Committee saw the risks as being "balanced." In today's statement, however, no such assessment is offered. Instead, we are told "the Committee is closely monitoring global economic and financial developments and is assessing their implications for the labor market and inflation, and for the balance of risks to the outlook."

So, what does this all mean? Prior to the meeting, some were looking for the FOMC to explicitly signal they were backing off the four rate hikes in 2016 implied by the December 2015 "dot plot." Why anyone would have been looking for such guidance, however, is a mystery as that was never as much as a remote possibility. It was more realistic to expect the Committee to acknowledge concern over a soft and uncertain global growth outlook, which they did. It was also more realistic to expect the Committee to acknowledge progress towards their 2.0 percent inflation target would be harder to come by and that market based indicators of inflation expectatiions have receded furether, which the Committee also did. Neither of these things, however, precludes a hike in the Funds rate target range at the March meeting should the economic data, domestic and foreign, warrant such a move. However much the financial markets may be discounting such an outcome, it was clear, at least to us, that it remains in the FOMC's best interests to keep that possibility in play. One question confronting the markets and the FOMC is to what extent the tightening in overall financial conditions will sway the Committee's decisions on subsequent funds rate hikes.

Our call has been, and remains, two 25-basis point hikes in the funds rate target this year, as we think both the growth and inflation outlooks to be more challenging than the FOMC collectively sees. That said, the FOMC did at this meeting what they needed to do – acknowledge challenges on both the domestic and global fronts while keeping their policy options open.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com