ECONOMIC UPDATE

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March 2016 FOMC Meeting: Global Risks Continue To Weigh On FOMC's Outlook

- The FOMC left the Fed funds rate target range unchanged, with the mid-point remaining at 0.375 percent.
- The implied trajectory of the Fed funds rate is notably softer than was the case in the December FOMC projections.

The FOMC surprised no one by holding the Fed funds rate target range unchanged at the conclusion of their two-day meeting. The FOMC surprised many by significantly softening the implied trajectory of the funds rate, largely on the basis of what the Committee perceives to be still elevated downside global economic and financial risks. So, despite only modest changes to their outlook for the U.S. economy the FOMC now projects a significantly lower Fed funds rate target range at year-end 2016 and year-end 2017 than was the case in December.

In their assessment of current economic conditions, the Committee noted economic activity has expanded at a moderate pace "despite global economic and financial developments of recent months." The view of business investment was downgraded, from expanding at a "moderate rate" in the January statement to "soft" in today's statement. It was also noted that inflation has "picked up in recent months." While noting their expectations for moderate economic growth and further strengthening of labor market conditions, the Committee once again declined to offer an assessment of the risks to their outlook. Instead, the Committee noted "global economic and financial developments continue to pose risks" whereas in their January statement the Committee stated they were closely monitoring these developments.

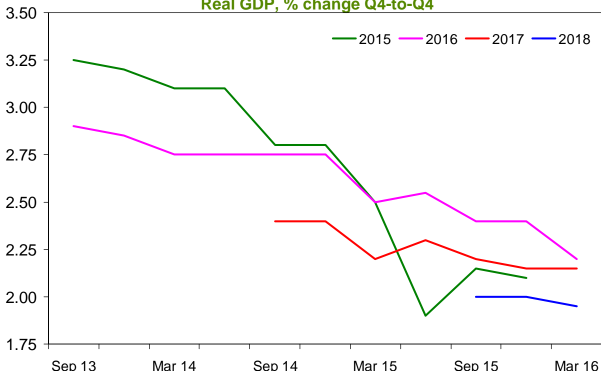
In their central tendency projections of real GDP growth, PCE inflation, and the unemployment rate, the Committee slightly downgraded their expected rate of 2016 real GDP growth, with the median Q4/Q4 growth rate now down to 2.2 percent from 2.4 percent in the December 2015 projections. The expected Q4 2016 average unemployment rate remains at 4.7 percent, but the expected Q4 2017 and 2018 rates are both one-tenth of one percent lower than was the case in the December projections. Expected Q4/Q4 PCE inflation, total and core, was revised slightly lower for 2016 but little changed for subsequent years.

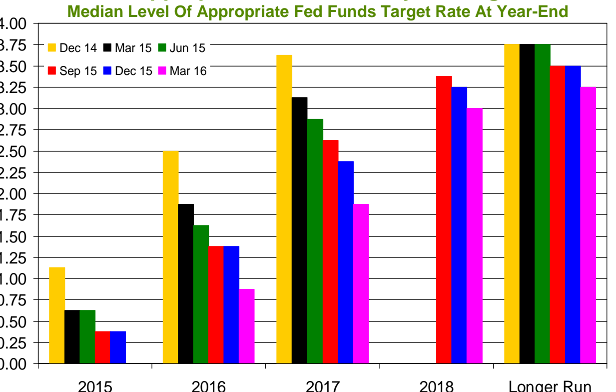
The most notable element of the FOMC's projections, however, is the significant softening of the trajectory of the Fed funds rate, as shown in the updated "dot plot." The implied year-end 2016 mid-point of the Fed funds target range is now 0.875 percent, a 50-basis point reduction from the 1.375 percent target range mid-point implied in the December 2015 dot plot. This suggest two 25-basis point hikes in the funds rate target range this year, not the four such rate hikes suggested by the December 2015 dot plot. Moreover, the implied year-end 2017 target range mid-point is also 50-basis points lower and the year-end 2018 mid-point 25-basis points lower than in the December projections. The longer-run "neutral" funds rate was also lowered, and now stands at 3.25 percent.

In her post-meeting press conference, Chairwoman Yellen took great pains to stress the dot plot is a projection and not a promise, which is a fair point. Each Committee member offers projections based on how they see the economy today and how they see it evolving over time, and as those assessments change it is natural for the projected path of the funds rate to change as well. Still, it cannot escape notice that the dot plot released today puts the Committee much more closely in alignment with market expectations than has been the case for some time.

Dr. Yellen stressed the FOMC is "not trying to engineer" an overshooting of their inflation target, which is how many interpreted the softer implied path of the funds rate. More likely, given the extent to which the Committee remains concerned about the downside risks to global growth, they are mindful of the potential for further appreciation of the U.S. dollar to not only do harm to U.S. exporters but to also ignite destabilizing capital flows from and increase the burden of dollar denominated debt in many emerging market economies. Put a different way, the Committee seems more concerned about financial channels, rather than economic channels, as the main way in which global factors could destabilize the U.S. economy.

The updated dot plot helps reconcile the FOMC's expectations of moderate growth in the U.S. economy and their concerns over global risks. Though Dr. Yellen explicitly stated "every meeting is a live meeting," their June meeting now seems the earliest time at which the FOMC would change the funds rate.





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