ECONOMIC UPDATE

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September 2016 FOMC Meeting: A Stronger Case To Act, Apparently A Stronger Case Not To

- 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 June FOMC projections.

The FOMC held the Fed funds rate target range unchanged at 0.375 percent at the conclusion of their two-day meeting. While this was widely seen as the most likely outcome, many analysts thought there to be at least an outside chance of a hike in the target range and we had not totally ruled this out. The FOMC opted to remain on hold despite stating the case for a rate hike "has strengthened" and, notably, there were three dissents from the vote to remain on hold. The FOMC also released their updated economic projections and the latest iteration of the "dot plot" which now shows a softer trajectory of the funds rate and a lower "neutral" funds rate relative to the June version.

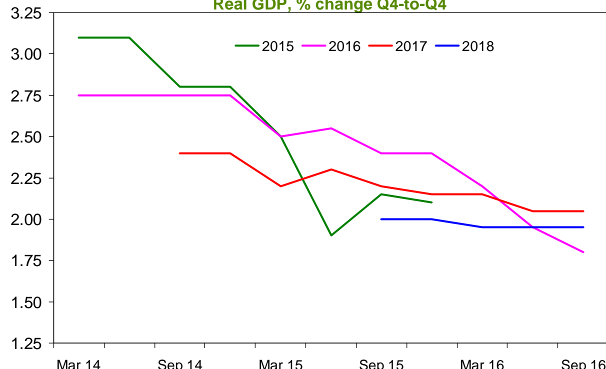
In their assessment of current economic conditions, the Committee noted the economy has continued to strengthen and that growth has picked up from the modest pace seen over the first half of this year. Job growth was characterized as "solid" despite there being little change in the unemployment rate. The Committee once again noted household spending has been growing "strongly" while business investment remains "soft." There was no change in their characterization of inflation or inflation expectations. One notable change is the assessment of risks to the near-term economic outlook – while in their June statement the Committee noted the risks had "diminished," in today's statement they note the upside and downside risks as "appear roughly balanced." This balanced assessment of risks is a necessary though not sufficient condition for another hike in the funds rate target range.

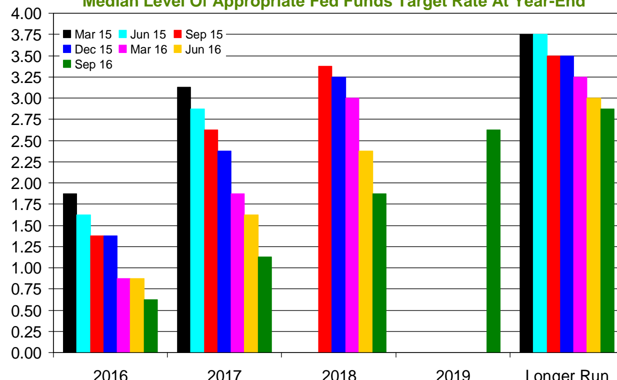
Projections for the unemployment rate and inflation were unchanged. The outlook for current year real GDP growth was lowered, but given how weak growth was over the year's first half, the 1.8 percent median projection for 2016 as a whole assumes faster 2H growth than we think will materialize. Additionally, the midpoint of the range of longer run projections of real GDP growth now stands at 1.9 percent, down from 2.0 percent in June, though we'd argue this is still too high given the outlook for labor force and productivity growth. Still, this downgrade, albeit modest, is consistent with recent comments by several FOMC members regarding the diminished prospects for longer term growth.

In what has become a routine outcome, the FOMC's latest projections show a significant softening of the trajectory of the Fed funds rate, as shown in the chart below. The implied year-end mid-points of the Fed funds target range now stand at 0.625 percent for 2016, 1.125 percent for 2017, and 1.875 percent for 2018. These reflect declines of 25-basis points, 50-basis points, and 50-basis points, respectively, from the June projections. As we anticipated, the projected longer term target range midpoint was lowered and now stands at 2.875 percent. Again, we'd argue this is still too high given the longer term growth outlook.

In her post-meeting press conference, Chairwoman Yellen offered an explanation as to why the Committee opted to keep the funds rate target unchanged despite a stronger case to act. She noted the rate at which labor market slack is being absorbed has slowed materially this year which, coupled with inflation remaining comfortably below the 2.0 percent target rate, gives the FOMC the latitude to remain patient. Dr. Yellen also pointed out the asymmetric nature of risks of a policy misstep. In other words, given the exceptionally low funds rate now in place, it would be far easier for the Committee to compensate for waiting too long to raise the funds rate than it would to compensate for raising the funds rate too quickly.

We do not disagree with that point, and have even made it ourselves. But, we nonetheless question the value of repeated statements by various FOMC members as to the number of rate hikes that will be appropriate in a given time period and what is now becoming a familiar comment as to a stronger case for a funds rate hike, only to be followed by no rate hike. Some argue today's statement lays the groundwork for a rate hike in December (no one expects a November move ahead of the Presidential election). While that may be the intent, we can't help but think leaving a three-month window simply leaves three months for something else to go wrong and preclude a December rate hike. Call us cynical, but there are only so many times you can lay out the case to act and then do nothing and still expect to maintain your credibility. We'd say that, if not there yet, the FOMC is perilously close to being there.





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