ECONOMIC UPDATE
REGIONS
June 14, 2017

June 2017 FOMC Meeting: Full Speed Ahead. At A Gradual Pace. For Now.

- The FOMC raised the mid-point of the Fed funds rate target range by 25-basis points, to 1.125 percent.
- The implied trajectory of the Fed funds rate in 2017 and 2018 is unchanged from the March 2017 projections.

As widely expected, the FOMC raised the mid-point of the Fed funds rate target range by 25-basis points to 1.125 percent. What was less certain, however, is the extent to which the FOMC would alter the implied trajectory of the funds rate going forward, in recognition of the recent deceleration in inflation. We did not expect any such move today, on the grounds that it is simply too soon for the Committee to have backed away from their oft-stated belief that inflation was on track for their 2.0 percent target rate. The revised "dot plot" shows no change to the implied path of the funds rate through 2018 and a slightly lower year-end 2019 target range mid-point, which likely simply reflects former FOMC member Tarullo having exited. In any event, the post-meeting statement was a bit more hawkish side than many anticipated.

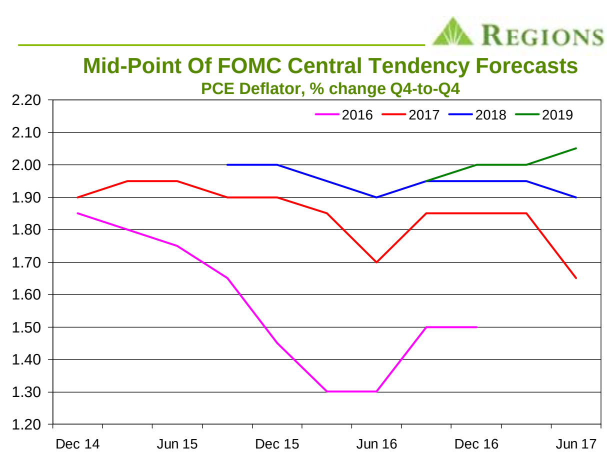
In their assessment of current economic conditions, the FOMC noted the economy continues to expand at a moderate rate. While noting a slower pace of job growth, job gains are characterized as "solid." The Committee also noted the recent deceleration in inflation, but continues to express its belief that inflation will stabilize around the 2.0 percent target rate "over the medium term." Still, while noting that the risks to the economic outlook appear "roughly balanced," the Committee goes on to add that they are "monitoring inflation developments closely."

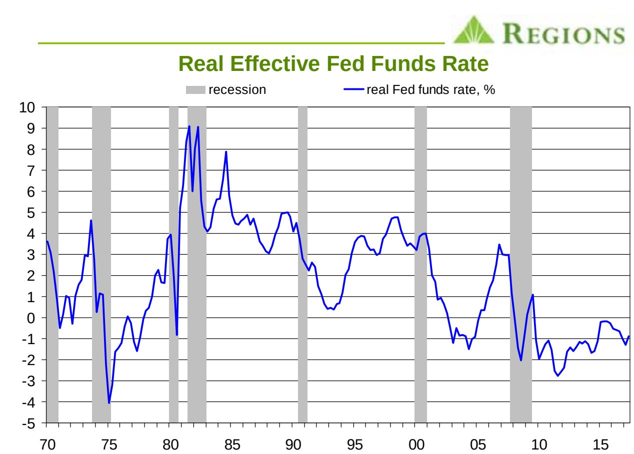
In her post-meeting comments, Fed Chairwoman Yellen noted that the recent deceleration in inflation appears to have been largely driven by "one-off" factors such as sharp declines in prices for cell phone service plans and prescription drugs. And, while the FOMC's updated economic projections show the mid-point of the range of forecasts for PCE inflation for 2017, on a Q4/Q4 basis, has dropped to 1.65 percent from 1.85 percent in the March projections, the longer-term outlook still has PCE inflation settling at 2.0 percent. The projections also account for the notable decline in the unemployment rate over recent months, with the mid-point of estimates for the Q4 2017 average now at 4.25 percent compared to 4.55 percent in the March projections, while the mid-point of the Q4 2018 average is now 4.15 percent compared to 4.45 percent in the March projections. At the same time, there were no material changes to the outlook for real GDP growth.

The FOMC laid out plans for trimming the Fed's $4.5 trillion balance sheet. The Committee deleted language in the post-meeting statement that reinvestment of balance sheet run-off would continue until normalization of the funds rate is "well underway," and struck the reference to the Fed's holdings of longer-term securities remaining at "sizeable levels." Today's statement notes that the FOMC expects a "balance sheet normalization program" to begin this year should the economy evolve as broadly anticipated. Proceeds from maturing assets will be reinvested only to the extent they exceed gradually rising caps, with the cap on proceeds from U.S. Treasury securities to rise in $6 billion increments until reaching $30 billion per month and the cap on proceeds from mortgage-backed securities to rise in $4 billion increments until it reaches $20 billion per month. Not specified, however, is when the program will begin or what the FOMC sees as the "equilibrium" level of the balance sheet. As Dr. Yellen noted, that will depend on other decisions made by the FOMC on the proper degree of monetary accommodation in light of economic conditions.

Dr. Yellen noted that the unemployment rate corresponding to full employment is highly uncertain. That the expected unemployment rate has been significantly lowered without a corresponding increase in expected inflation suggests the FOMC still sees an elevated degree of labor market slack. As such, the gradual removal of monetary accommodation reflects, in Dr. Yellen's words, the "appropriate management of risks," specifically, the risk that inflation will accelerate to an extent that would require a much faster pace of rate hikes. Our view, which we have expressed before, is that the FOMC sees a negative real effective funds rate as being far more accommodative than is warranted even in an relatively modest growth environment.

While there is little in the post-meeting statement or Dr. Yellen's press conference to suggest the FOMC is wavering on their expected path of the Fed funds rate, the inflation data over coming months will be key.





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