ECONOMIC UPDATE

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September 2017 FOMC Meeting: (Not So) Boldly Going Where No Central Banker Has Gone Before

- The FOMC left the mid-point of the Fed funds rate target unchanged at 1.125 percent.
- The "dot plot" again implies a third funds rate hike by year-end; the FOMC announced balance sheet "normalization" will begin in October.

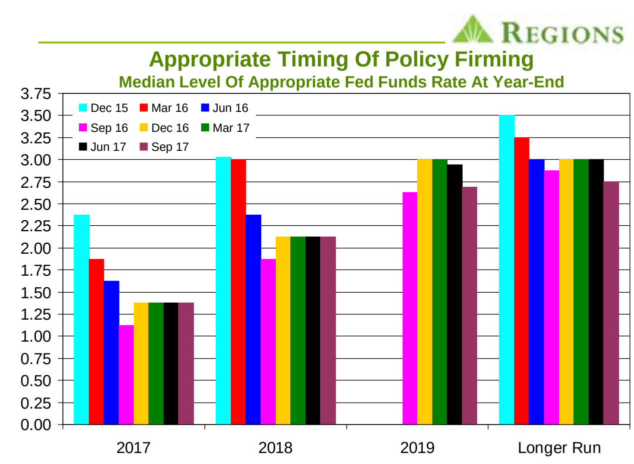
As widely expected, the September FOMC meeting saw the Committee make no changes to the Fed funds rate target range, meaning the mid-point remains at 1.125 percent, while announcing they will initiate balance sheet normalization in October along the path laid out at their June meeting. As was also expected, the latest rendition of the "dot plot" shows a median a year-end 2017 Fed funds rate target range mid-point of 1.375 percent, implying one more 25-basis point hike before year-end. There were a few modest changes to projections for real GDP growth, the unemployment rate, and inflation. There were no dissents in today's vote – while there has been at least some division within the Committee on the appropriate path of the funds rate, there has been none, at least thus far, on the appropriate path of the balance sheet.

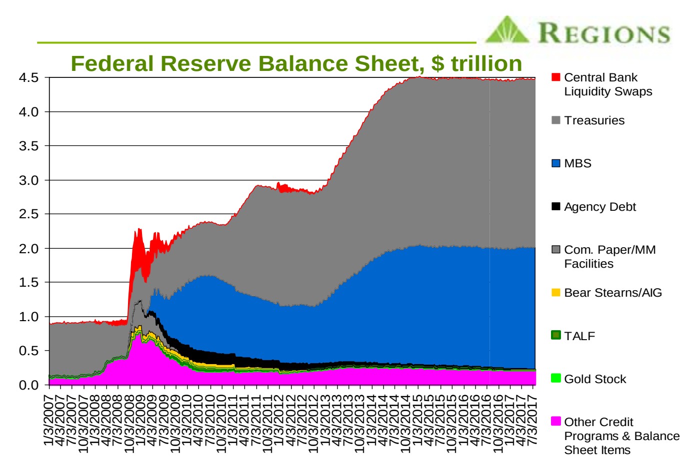
The assessment of current economic conditions was largely unchanged from the July statement. Economic activity is again characterized as "rising moderately so far this year" with the labor market continuing to strengthen. The Committee did point to faster growth in business investment spending over recent quarters. As expected, there was an acknowledgement that there will be near-term effects of the recent hurricanes but it was also noted "the storms are unlikely to materially alter the course of the national economy over the medium term." While acknowledging the recent deceleration in inflation, the Committee continues to maintain that inflation will "stabilize around 2.0 percent over the medium term."

The updated economic projections show expectations of a slightly faster pace of real GDP growth (Q4/Q4) in both 2017 and 2018, with no change in anticipated 2019 growth. Expectations for the unemployment rate, on a Q4 average basis, were marked down slightly for 2018 and 2019; the longer-run (i.e., "full employment") rate was not changed, though we would not have been surprised to have seen this taken down a bit. More interestingly, the expected Q4/Q4 change in both headline and core PCE inflation was lowered by 10 basis points for 2017, but there were no changes in the anticipated 2018 and 2019 rates. This implies that most FOMC members see the recent deceleration in inflation as being transitory, not structural, in nature.

The latest dot plot implies one more 25-basis point hike in the Fed funds rate target range by year-end 2017, which would leave the mid-point at 1.375 percent. Interestingly enough, one member still shows the appropriate year-end 2017 mid-point at 1.625 percent. The dot plot again implies three additional 25-basis point hikes in 2018, but only two such hikes in 2019 whereas before three hikes had been implied. To us, the most interesting element of the latest dot plot is the "longer run" (or, if you prefer, neutral) funds rate was lowered from 3.00 percent to 2.75 percent. This implies policy is closer to a neutral stance, and hence less accommodative, than had previously been thought to be the case. We will add one significant caveat pertaining to the dot plot, and that is that given the number of vacancies on the FOMC at present – recall the September meeting is the last for outgoing Vice Chairman Fischer – changes in the composition of the FOMC somewhat diminish the signaling value of the projections published today.

The FOMC announced the process of balance sheet "normalization" will commence in October, following the (gradual) path laid out in June, about which we'll offer a few points. First, we're hesitant to use the word "normalization" in this context. Nothing about monetary policy over the past decade has been normal, and in the absence of a terminal level for the balance sheet and, as Dr. Yellen noted in her press conference, the possibility that the balance sheet may yet again be employed as an active policy tool, we may never get to "normal." Also, keep in mind that while the FOMC is taking, at least at first, small steps towards paring down its balance sheet, other central banks continue to add accommodation via asset purchases. In other words, in the context of global liquidity, the FOMC's move is barely noticeable. The real test of the impact on market interest rates will come when the FOMC is being more aggressive and foreign central banks have started the process of unwinding their balance sheets. Still, even if at a modest pace, the FOMC is going into uncharted waters, so we won't take anything for granted in terms of how the markets will react.





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