"Waiting Too Long Could Mean Faster Hikes Later"

March 15, 2017

As expected, **the FOMC raised the Fed Funds rate by 25 bps today**, bringing the target range to 75-100 bps. Ahead of the Fed's latest forecasts, the market had priced in a 60% chance of further rate hike in June and 41% of another rate hike in September; after the new predictions (*Table 1 below*), these probabilities dropped to 47% and 30%, respectively and 2-year yields dropped from 1.39% to 1.30%. Even though the median estimates for Fed Funds at the end of 2017 and 2018 were identical to Committee's estimates from December 2016 and the Committee's economic projections were essentially unchanged, the market reduced the likelihood of future policy moves through year-end (*Chart 1 on the following page*).

Table 1. **Economic Projections of Federal Reserve Board Members and Presidents, March 2017**

Variable	2017	2018	2019	Longer Run
Change in real GDP, %	2.0 to 2.2 ≈ ↑	1.8 to 2.3 ≈ ↑	1.8 to 2.0 ≈	1.8 to 2.0 ≈
December Forecast	1.9 to 2.3	1.8 to 2.2	1.8 to 2.0	1.8 to 2.0
Unemployment rate, %	4.5 to 4.6 ≈	4.3 to 4.6 ≈ ↓	4.3 to 4.7 ≈ ↓	4.7 to 5.0 ≈
December Forecast	4.5 to 4.6	4.3 to 4.7	4.3 to 4.8	4.7 to 5.0
PCE inflation, %	1.8 to 2.0 ≈ ↑	1.9 to 2.0 ≈	2.0 to 2.1 ≈	2.0 ≈
December Forecast	1.7 to 2.0	1.9 to 2.0	2.0 to 2.1	2.0
Core PCE inflation, %	1.8 to 1.9 ≈	1.9 to 2.0 ≈	2.0 – 2.1 ≈ ↑	n/a
December Forecast	1.8 to 1.9	1.9 to 2.0	2.0	n/a
Fed Funds (average)	1.40% ↑	2.32% ↑	2.89% ↑	2.97% ↑
December Forecast	1.37%	2.23%	2.80%	2.95%
Fed Funds (median)	1.375% ≈	2.125% ≈	3.000% ↑	3.000% ≈
December Forecast	1.375%	2.125%	2.875%	3.000%

Source: Federal Reserve

Note: Excludes the three highest and three lowest projections for each variable in each year (except average and median Fed Funds rate figures, which include all participants.) Arrows (↑,↓ and ≈) indicate direction of change in forecast from December 2016 to March 2017. Real GDP and inflation projections are from Q4 of the previous year to Q4 of the year indicated. PCE inflation refers to the price index for personal consumption expenditures. Projections for the unemployment rate are for the average rate during Q4 of the year indicated.

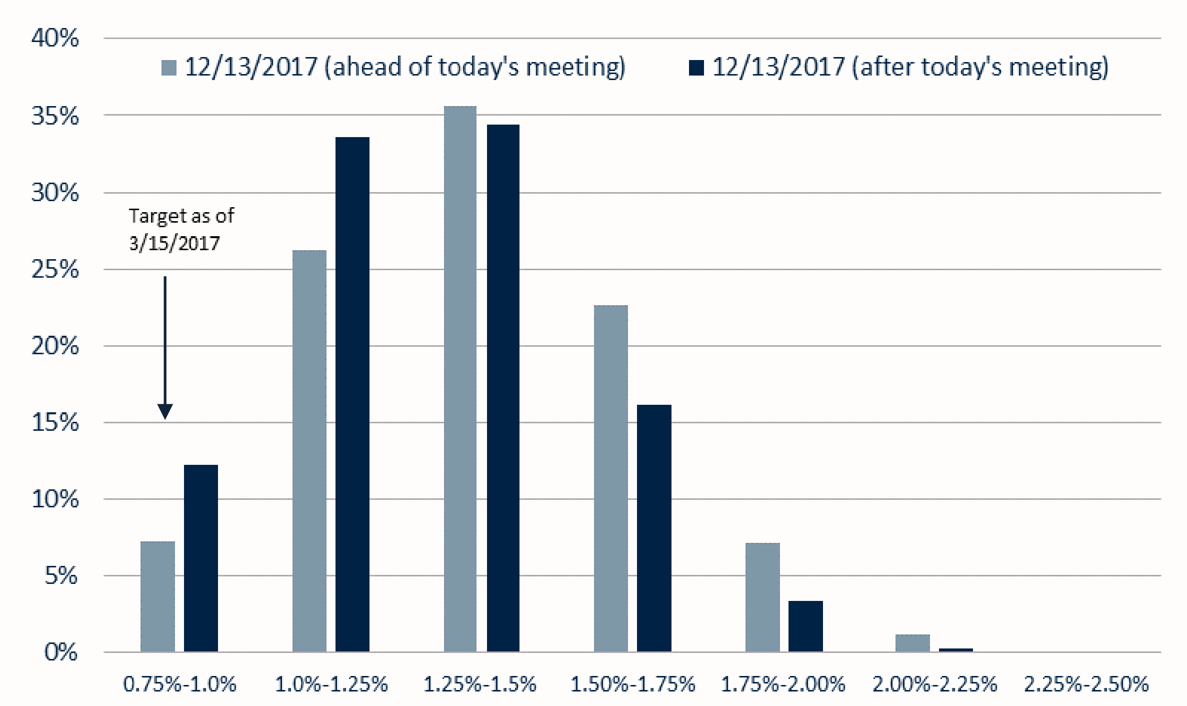
Minneapolis Fed President Neel Kashkari **dissented** from the rest of the FOMC, preferring to maintain rates at 50 – 75 bps. He had previously stated that the Fed has "stronger tools to deal with high inflation than low inflation," suggesting that the risks of low inflation still dominate in his mind. As if to counter this view and highlight the importance of straying too far above *or* below its goal, today's statement referenced the Fed's "symmetric" inflation goal—the first use of this term in several years.

During the press conference, Chairwoman Yellen was asked about **fiscal policy**, and confirmed that the Fed's forecasts did not incorporate possible policy changes with regard to infrastructure spending and tax cuts, noting that "there is great uncertainty about the timing, the size [and] the character of policy changes that may be put in place" and that there is "plenty of time to see what happens."

She also addressed a question on **what constitutes a "neutral" Fed Funds rate**, and suggested that monetary policy, even after today's rate increase, remains accommodative, given her assessment that a neutral real Fed Funds rate "might be close to one percent" even as "some recent work" suggests that it could be closer to zero in real terms. (With today's move and headline PCE inflation at 1.9%, note that the current real Fed Funds rate stands at -0.9% to -1.15%.) She also noted that the low level of the neutral rate is influenced by shifts in fiscal policy, slowing population growth and slow productivity growth, as well as "headwinds that are left over from the financial crisis" (such as "restraint and risk aversion on the part of households and businesses that's held back spending decisions") although such caution is likely to "gradually dissipate over the years."

Despite several questions that highlighted the weak start to 2017 (including the fact that the Atlanta Fed's tracker of current quarter GDP stands at just 0.9% and that wage growth has shown very little upward momentum), the Chairwoman remained steadfast with regard to her outlook for 2017. When asked "what message [she is] trying to send consumers with [today's] particular rate hike," Chairwoman Yellen responded that "**the simple message is: the economy's doing well.** We have confidence in the robustness of the economy and its resilience to shocks." She noted that the Committee's decision today reflected the view "that waiting too long to scale back some accommodation could potentially require [the Committee] to raise rates rapidly some time down the road, which in turn could risk disrupting financial markets and pushing the economy into recession." To the extent that the economy continues to grow—as measured by employment and inflation—there is little reason to believe that the Fed will deviate from its current forecast for another two rates hikes later in 2017.

Chart 1. **Probability of December 2017 Fed Funds Rate as Implied by Fed Funds Futures**



Source: Bloomberg

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