ECONOMIC UPDATE

REGIONS

December 13, 2017

December 2017 FOMC Meeting: Once More With . . . Ambivalence?

- The FOMC raised the mid-point of the Fed funds rate target by 25 basis points, taking it to 1.375 percent
- The "dot plot" again implies three 25-basis point hikes in the target range mid-point in 2018 and a long-term mid-point of 2.75 percent

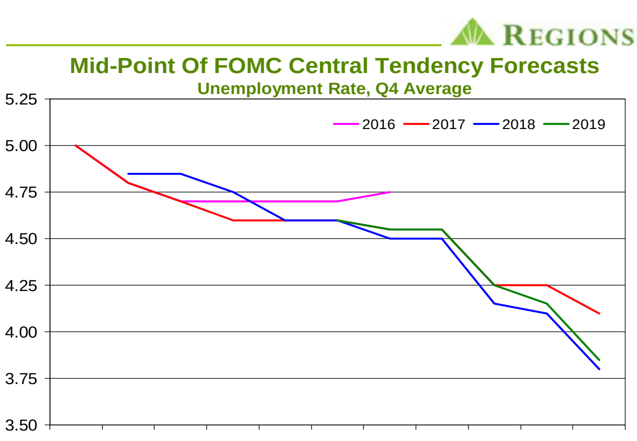
As widely anticipated, the FOMC raised the mid-point of the Fed funds rate target range by 25-basis points at the conclusion of their two-day meeting, putting the mid-point at 1.375 percent. The updated "dot plot" implies three additional 25-basis point hikes in 2018 and an additional two such hikes in 2019. Their updated economic projections show the Committee expects faster real GDP growth in 2018 and 2019 than was the case in their September projections, and also expects a lower unemployment rate relative to the September projections. At the same time, however, their inflation outlook is basically the same, which is more than a little surprising given how much emphasis many FOMC members have placed on tightening labor market conditions as a precursor to inflation in the broader economy. Also notable is that there were two dissents to today's vote, with Chicago Fed President Evans and Minneapolis Fed President Kashkari voting against the rate hike.

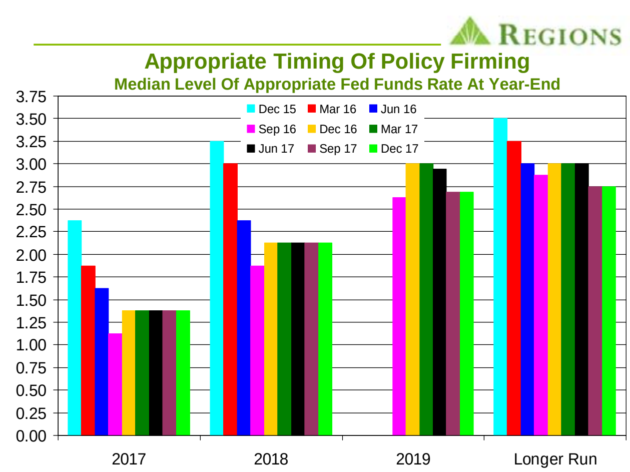
The assessment of current economic conditions was largely unchanged from the November statement. Economic activity is again characterized as "rising at a solid rate" and the Committee again pointed to the pick-up in business investment spending. As with the November statement, today's statement notes that both headline and core inflation have fallen this year and continue to run below the 2.0 percent target rate. Still, the Committee continues to maintain that inflation will "stabilize around 2.0 percent over the medium term." One notable change centers on the labor market. While in the November statement labor market conditions were expected to "strengthen somewhat further" today's statement notes labor market conditions "will remain strong." Fed Chairwoman Yellen explicitly noted this change in her post-meeting press conference, explaining that the Committee's view of the labor market has not changed, but the pace of improvement seen over the past several quarters is simply not sustainable without the labor market overheating.

With the funds rate hike all but a given, the bigger question around this month's meeting was the extent to which the Committee's central tendency forecasts would be modified, particularly with the likelihood of significant tax legislation being signed into law soon. On a Q4/Q4 basis, real GDP growth for 2017 was revised up to 2.50 percent from 2.35 percent in the September projections, which reflects faster growth in Q3 than had been anticipated. More strikingly, the projection for 2018 shows growth of 2.50 percent compared to 2.15 percent growth in the September projection. At the same time, the Q4 2018 average unemployment rate is now expected to be 3.80 percent, down from 4.10 percent in September, while the Q4 2019 average is now pegged at 3.85 percent, down from 4.15 percent in September. Dr. Yellen noted in her press conference that the tax bill is expected to add to economic activity but the degree and timing of any such boost is uncertain. Still, any such boost will largely wash out over time; growth in 2019 is pegged at 2.05 percent (up from 1.90 percent), and the projected long-term growth rate is now pegged at 1.95 percent (up from 1.85 percent).

That this somewhat improved outlook is accompanied by virtually no change in the inflation forecasts, and in turn no change in the path of the funds rate implied by the dot plot, is hard to reconcile. Implicit in the set of projections is either a surge in labor productivity or a surge in labor force participation, if not both. It could be that most FOMC members anticipate most of the growth effects from the tax bill will come from improved business investment, which would lift labor productivity growth, thus enhancing the economy's capacity for growth without touching off inflation pressures, though Dr. Yellen noted that the tax bill is also expected to provide a lift to consumer spending. On the whole, this set of projections seems not to clear the internal consistency hurdle. We will, however, note that it probably isn't worth putting too much stock in this set of projections given what will be significant changes in the composition of the FOMC over coming months.

The most notable of those changes is the looming departure of Chairwoman Yellen. If we're permitted a brief aside, we will miss Dr. Yellen a great deal. Regardless of what one thinks about the policy moves made under her watch, she has been the epitome of dedication to service and has conducted herself with nothing but the highest of class in what at times have been trying circumstances.





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