ECONOMIC UPDATE
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June FOMC Meeting: The Direction Is Clear, The Timing Not So Much

- The FOMC left the Fed funds rate target range unchanged, with the mid-point of the target range remaining at 2.375 percent
- The updated "dot plot" shows a sizable cohort of the FOMC in line with market expectations of Fed funds rate cuts by year-end 2019

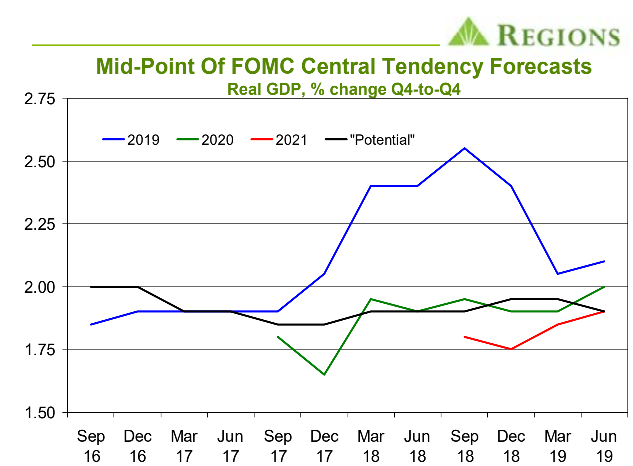
The FOMC made no changes to the Fed funds rate target range at the conclusion of their two-day meeting, leaving the mid-point of the target range at 2.375 percent. At the same time, however, the Committee laid the groundwork for at least one cut in the Fed funds rate by the end of 2019 should conditions warrant such a move. The post-meeting statement incorporates the language used of late by Chairman Powell, vowing to "act as appropriate to sustain the expansion," so while patience may still be a virtue, it is no longer a part of the Committee's guidance to the financial markets. There was one dissent to the vote to keep the funds rate target rate unchanged, as St. Louis Fed President Bullard voted for a rate cut.

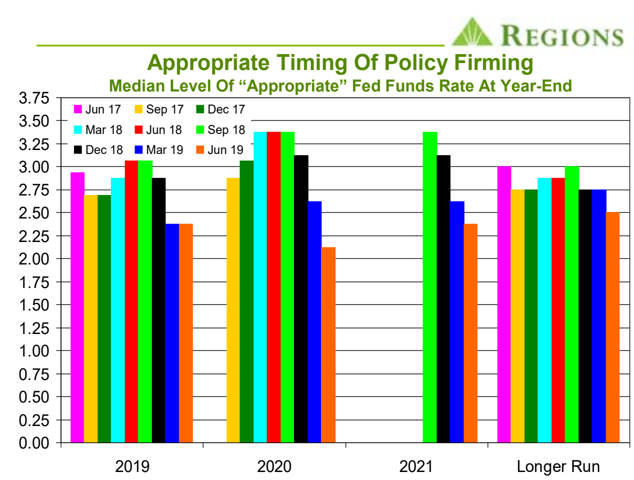
There were some material changes to the FOMC's assessment of current economic conditions. Growth is now described as "moderate" whereas in the May statement growth was described as "solid." The Committee also noted that "indicators of business investment have been soft," as has been apparent in the high frequency data, which to a large extent likely reflects rising uncertainty over the course of trade policy. It was noted that market-based measures of inflation have declined, as opposed to the "have remained low" characterization used in the past several statements. More tellingly, the Committee notes that "uncertainties about the (baseline) outlook have increased." This, along with "muted inflation pressures," sets the stage for the Committee pledging to "act as appropriate to sustain the expansion."

While there was a modest upgrade to the FOMC's central tendency projection for 2019 real GDP growth – from 2.05 percent to 2.10 percent on a Q4/Q4 basis – keep in mind that with Q1 growth of 3.1 percent and Q2 growth now tracking around 2.0 percent, this sets a low bar for growth over the second half of 2019. Growth would need only to average just over 1.5 percent over the back half of 2019 to hit the full-year projection of 2.10 percent. Put in this context with growing downside risks, the concept of "pre-emptive" funds rate cuts is more clear than is the case if one were to look only at the full-year projections. Expectations of the Q4/Q4 rate of PCE inflation were marked down to 1.55 percent from 1.75 percent in the March projections, with Q4/Q4 core PCE inflation marked down to 1.75 percent from 1.95 percent in the March projections.

The most striking changes in the Committee's projections are found in the dot plot. While the median year-end 2019 Fed funds target range mid-point remains at 2.375 percent, seven Committee members indicate they see two 25-basis point rate cuts by year-end as appropriate given their outlook for growth and inflation, while one member signals one such cut as appropriate. Eight members see no changes in the funds rate by year-end as being appropriate given their outlook for growth and inflation, and one member sees a 25-basis point rate hike as being appropriate. While we expected the "median dot" to remain at 2.375 percent, the underlying shift was more pronounced than we expected, to the point that it would have taken only one more member signaling a single rate cut to shift the median dot down. Still, the median dot at year-end 2020 now stands at 2.125 percent, which is 50 basis points lower than in the March projections. The median estimate of the "neutral" funds rate now stands at 2.50 percent, down from 2.75 percent in the March projections – way back in 2013 the median estimate of "neutral" stood at 4.00 percent.

Chairman Powell opened his post-meeting press conference by stating that he and his colleagues have "one overarching objective – to sustain the expansion." When asked why not cut the funds rate now, Chairman Powell stated that the Committee is just not there yet – while business investment and manufacturing have clearly weakened, with the consumer sector remaining "solid" and the services sector continuing to expand, the Committee would basically need to see evidence of more broad based weakening before moving on the funds rate. That is an interesting point, as it raises the question of just how much such evidence there is likely to be by time the July 30-31 FOMC meeting rolls around, though this month's G-20 meeting looms as a significant wild card. In short, the direction of monetary policy seems abundantly clear, but the same cannot be said for the timing of policy changes.





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