Northern Trust

ECONOMIC UPDATE

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• December FOMC Meeting: Staying Patient

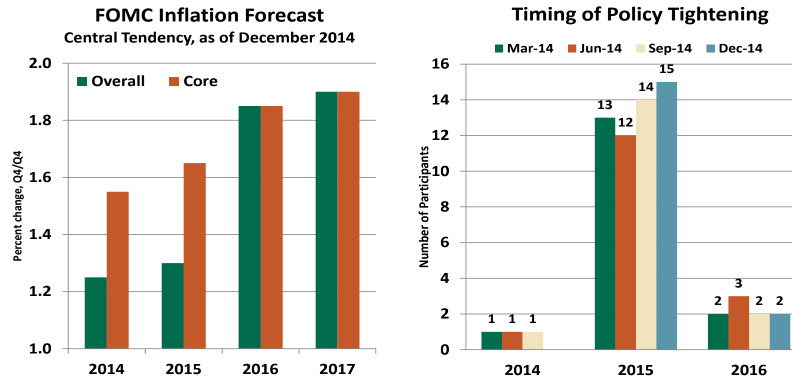
Amid volatile markets outside the meeting room and apparently some active discussion inside, the Federal Open Market Committee (FOMC) concluded its final meeting of the year by dropping its pledge to keep rates at zero for "a considerable period." This passage was replaced with an assertion that the Fed "can be patient in beginning to normalize the stance of monetary policy."

The statement took the rare step of noting that the new language was consistent with previous guidance. This seems designed to keep markets from rushing to premature conclusions about the onset or pace of U.S. interest rate hikes. This reassurance also avoids adding to the pressure already felt by some emerging markets, which might tend to experience accelerated capital flight if U.S. yields were to rise sharply.

The Committee seemed to minimize the impact of recent energy price developments in its outlook. The FOMC expects inflation to rise gradually toward its 2% target as "the transitory effects of lower energy prices and other factors dissipate." Risks to the outlook were seen as "nearly balanced," a perspective that contrasts with the recent turmoil in financial markets.

In her press conference this afternoon, Fed Chair Janet Yellen depicted the energy price realignment as a net positive for the United States. She noted that direct trade and financial linkages between Russia and the United States are small. While the Fed is watching developments in both arenas, the tone that Yellen offered around them both was reassuring.

In addition to its narrative communication, the FOMC released an updated set of its members' economic projections. The collective left the growth outlook mostly unchanged while revising the expected trajectory of unemployment to a slightly lower level. A bigger shift was seen in overall inflation predictions for 2014 and 2015, which are noticeably lower. However, the 2016 forecast remained at 2%, and the outlook for core inflation (which excludes food and energy) showed only marginal changes.



Source: Federal Reserve

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The Fed’s Summary of Economic Projections now reflects a more-accommodative federal funds rate path during 2015-2017. The median forecast for 2015 at 1.125% is 25 basis points lower than the September forecast. Fifteen of the 17 participants now see short-term rates rising for the first time next year. The median forecast for the federal funds rate in 2016 fell 37.5 basis points to 2.5%, suggesting a shallow trajectory of tightening relative to past precedents.

The Fed seemed to downplay recent trends in the energy markets.

Today’s decision and the communication around it attracted three dissents, two from the hawkish side and one from the dovish side. President Narayana Kocherlakota of Minneapolis repeated his objection, fearing that the Fed was losing sight of its inflation goal by not remaining more accommodative. Presidents Richard Fisher (Dallas) and Charles Plosser (Philadelphia) would have preferred statement language that was more aggressive in moving toward restraint.

This was the first time in more than three years that there had been three dissents at a meeting, but this shouldn’t be taken as an indication that the Fed is a house divided. First, all three dissenters are not only rotating off the FOMC at the start of next year, but all three have announced their plans to retire from their posts. Second, Janet Yellen has shown some skill at finding common ground among a diverse set of opinions over the past few FOMC meetings. We view this as a strength that can be leveraged during potentially difficult meetings to come.

The Federal Reserve focuses on the fundamentals, and primarily U.S. fundamentals. Today’s decision was therefore unlikely to be swayed much by recent market unrest. American labor markets have been strengthening, and the outlook for growth looks solid.

Nonetheless, as the full extent of energy price realignment works its way through the economic and financial system, its impact could affect the design of any tightening program. We continue to think that tightening will commence in September of next year and proceed in a very measured way thereafter. This slow pace, combined with the Fed’s very large balance sheet, keeps U.S. monetary policy in a range that should be very supportive both here and overseas.

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