Northern Trust

ECONOMIC UPDATE

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Dropping the "Patient" Word Does Not Mean the Fed Is "Impatient"

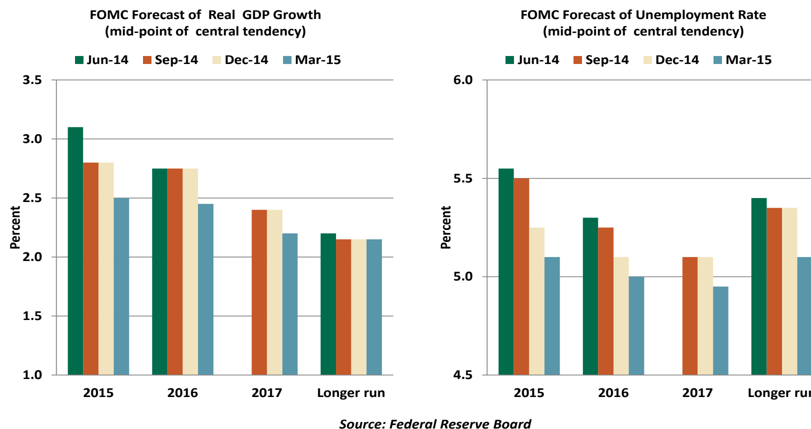
Markets sometimes hang on every word from the Federal Reserve. In recent weeks, they had been hanging on a single word: "patient." This term had been used to describe the prospective approach to policy tightening in recent statements; analysts speculated that removing the term would be a strong signal that rates would be heading up soon.

Well, the word was removed from the statement that followed today's Federal Open Market Committee (FOMC) meeting. But the rest of the statement, and the color around it shared by Fed Chair Janet Yellen, suggests that it may yet be a while before monetary policy changes.

Chair Yellen indicated that all meetings after April are on the table for a rate hike, and 15 out of the 17 FOMC members expect to tighten monetary policy in 2015. However, a June rate increase may be less likely than previously thought because economic data may not provide the support necessary for tightening monetary policy. The litmus test for raising the policy rate is continued improvement in the labor market and adequate confidence that inflation will move back to its 2.0% inflation target from the considerably low readings of today.

The summary forecasts released today point to the Fed moving at a less-rapid pace compared with the forecast path of the federal funds rate in December 2014. The median federal funds rate forecast is down 50 basis points to 0.625% in 2015; the 2016 and 2017 forecasts also show a reduction of the projected federal funds rate. The median federal funds rate for the long run stands at 3.75%, unchanged from the earlier forecast.

The FOMC statement downgraded the growth path of the economy for 2015, partly reflecting soft recent economic numbers and weakness in exports. The Fed did not mention the dollar directly, but the reference to weakness in exports is a direct acknowledgment of the impact of the dollar's strength. The unemployment rate considered consistent with full employment is now 5.0%-5.2%, down from 5.2%-5.5%. The reduction implies that the Fed believes there is considerably more slack in the economy.



Source: Federal Reserve Board

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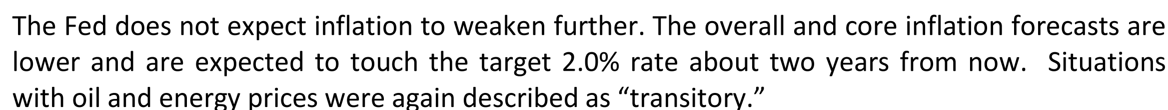

The Fed does not expect inflation to weaken further. The overall and core inflation forecasts are lower and are expected to touch the target 2.0% rate about two years from now. Situations with oil and energy prices were again described as "transitory."

The Fed included "international developments" as part of the "wide range of information" that will be considered in its policy strategy. This is a generic phrase to capture all geopolitical events. More than 20 central banks have lowered their policy rates in 2015.

The Fed's imminent tightening plans are not viewed favorably in international circles. Christine Lagarde, the head of the International Monetary Fund, noted that emerging markets are likely to react unfavorably even to modest tightening of monetary policy in the United States. In this context, it should be noted that the Fed's mandate has a domestic orientation and thus it is unlikely to change its focus away from the U.S. economy. But concern from international economic leaders will certainly not push the Fed to tighten sooner.

Bond and equity markets rallied following the Fed's announcement, mainly because they viewed the Fed's rhetoric and forecasts to imply a much more gradual tightening path than previously assumed. This expectation will certainly be revisited and revised as new data and commentary emerge in the coming weeks.

We continue to expect the first move in September, when there is additional progress on growth and clarity on inflation. But we would agree with the new "dot charts" that tightening will proceed very slowly and cautiously from there. It's taken a lot of patience to bring the U.S. economy back from the depths of 2008, and it would be ruinous to undo that progress by being too hasty to normalize monetary policy.

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