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Instant Analysis

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Instant Analysis of Today's March FOMC Statement

FOMC removes "patient" language- a June or Sept. liftoff on the table, April ruled out.
New guidance – FOMC must see further improvement in the labor market and be reasonably confident that inflation will move back to 2 percent over medium term
Fewer "Hawks" on the Committee pushes median dot-plot lower in 2015, 2016, and 2017
FOMC median now sees only two rate hikes by end of year (Median 0.625% End-2015).
Dot-plot median at end of 2016 now 1.875% versus 2.5% at December meeting
Dot-plot median at end of 2017 now 3.125% versus 3.65% at December meeting
Long-run Fed Funds median still at 3.75%, though more members see 3.5% as long-run rate
Modest downgrade of current economic conditions, mentions export weakness
Inflation expected to remain low over the near-term
Inflation decline still seen as transitory- monitoring inflation developments closely
Market reaction- S&P 500 +1.2%, 10-Yr Treasury -12.8 bps to 1.92%, USD weakens

A cautious FOMC statement and a sharp downward revision in the "dot-plot" of the Fed funds rate path over the next three years kept a lid on interest rates and the US dollar despite a generally upbeat assessment of the labor market and only a modest downgrade in the central tendency U.S. growth outlook over the next three years.

As expected, the FOMC removed the "patient" forward guidance on when it will normalize the stance of monetary policy, replacing it with two new criteria. 1)- the FOMC wants to see further improvement in the labor market, and 2) the FOMC needs to be reasonably confident that inflation will move back to its 2 percent objective over the median term. In other words, a June or September 2015 rate hike is still on the table, but it is not assured and will be data dependent.

The big news today was the large downward revision in the FOMC participants expected Fed funds rate targets over the next three years. While 15 of 17 FOMC participates saw 2015 as the appropriate year to firm monetary policy, the same number as in December, the number of rate hikes expected at the median over the next three years was revised far lower. This downward revision in the median in-part reflects the changing composition of FOMC participants rather than a material change in the economic or inflation outlook.

The March FOMC "dot-plot" now shows a median fed funds rate at 0.625% at the end of 2015, 1.875% at the end of 2016, and 3.125% at the end of 2017. This is about 50 basis points lower, or more, in each of the next three years than where the median "dot-plot" was in December. In other words, if the FOMC starts normalizing interest rates in June of this year, the pace of the rate hikes are expected to remain extraordinarily-slow by historical standards. Moreover, eight FOMC participants now see 3.5% or lower as the long-run fed funds target rate compared to only four who saw it that way in December.

Looking at the FOMC's latest economic projections, the central tendency forecasts for real GDP in 2015, 2016, and 2017 were revised down a modest 0.2 to 0.3 percentage points from there they were in December. On the other hand, the unemployment rate projections were also revised lower 0.1 to 0.2 percentage points- a nod to the robust recovery in the labor market that is on-going. There was a bigger down revision in headline PCE inflation forecast for 2015, but the PCE inflation forecasts for 2016 and 2017 were nearly unchanged, suggesting the FOMC still sees the current bout of deflation as transitory and that by next year inflation will be back closer to target.

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Bottom-line, the FOMC took the safety off their rate hike gun today by removing the “patient” forward guidance language and replacing it with more data driven guidance: further improvement in the labor market and “reasonable confidence” in inflation returning to their 2 percent target over the medium term. While Chair Yellen, ruled out an April rate hike, the June and September FOMC meetings remain in their sight as the most likely dates to begin the normalization of the Fed funds target rate. However, the large downward revision in PCE inflation this year, the sluggish start to the year, and continuing concerns about a strong dollars impact on export growth, has changed FOMC expectations about the pace of tightening expected. After the FOMC’s initial rate hike, the subsequent rate hike pace is likely to be somewhat slower than previously forecast over the next two years.

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