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This Week's FOMC Meeting



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The Federal Open Market Committee meeting this week will receive a great deal of attention by investors, economists, and the media because of pre-announced changes in the communication policy aimed at increasing transparency. Foremost, all FOMC participants will not include their expectations for the appropriate level of the federal funds rate in the Summary of Economic Projections. This table will be updated for the January 24–25 meeting, and will show the forecast range and the central tendency (excludes three highest and three lowest forecasts) for real GDP growth, the unemployment rate, PCE inflation, core PCE inflation and now the federal funds rate for 2012, 2013, 2014 and the long run.

The FOMC also plans to publish two new charts that will allow observers to better understand individual Committee member forecasts even though individuals will not be named. The first chart will use bars to indicate the number of Committee members that expect the first rate hike to occur in a specified calendar year (2012–2016). The second chart will use dots to represent individual policymakers' projections of the appropriate federal funds rate at the end of the next several years and in the long run.

These charts will help Fed Watchers work out how clustered or spread out funds rate forecasts are at this time. We expect the range of forecasts to be wide, but we also expect that the majority of FOMC members will call for the first rate hike in 2014. Thus, the Fed will have to change the mid-2013 guidance that has been in the FOMC statement for quite some time. We'd like to see this sentence removed rather than updated, although

an update seems more likely for this meeting.

By the end of 2014, we anticipate that the median estimate for the funds rate will be 1% or less, which would be consistent with market expectations. A key difference, though, is that market expectations for GDP growth have been running lower than FOMC forecasts, while inflation calls have been similar. This suggests that the Fed has a lower reaction function or simply more tolerance for stronger economic growth versus the market.

The FOMC also plans to release a narrative that will describe the key factors underlying members' forecasts and provide qualitative information about members' expectations for the Federal Reserve's balance sheet. This narrative will likely indicate that the majority of the FOMC members anticipate some balance sheet expansion this year, although we do not expect more than a few are ready to expand it today.

An additional communication change is in the works, but it is not clear that it will be released this week. The Fed has been working on a formal statement of longer-run goals and policy strategy, but a draft of this statement reviewed at the last FOMC meeting required adjustments. The adjusted statement will be considered at this week's FOMC meeting and could be released to the public. A recent WSJ article indicated that this statement is close to being finalized and will be released this week.

Economists have been buzzing about whether or not this mission statement will include a formal inflation target and possibly even a formal unemployment rate target. Fed Watcher Jon

Hilsenrath of the Wall Street Journal wrote last week: “The Fed is likely to state more directly than before that it has a goal of about 2% inflation over the long run. It is likely to lay out levels of unemployment that Fed officials believe are achievable, with the understanding that the unemployment landscape could shift over time.”

While such an outcome could fall short of a formal target, I sincerely hope that this mission statement will further anchor medium- and long-term inflation expectations. That would be helpful should the economy significantly exceed or fall short of consensus growth expectations in the next couple of years.

Following this FOMC meeting, we will reevaluate our outlook for monetary policy in 2012. Currently, we anticipate another \$400

billion increase in the Fed’s balance sheet to occur sometime around the middle of the year, but recent developments suggest the Fed could decide to keep its balance sheet unchanged. Economic data in the United States continue to show signs of strength, while risks to the growth outlook from external shocks have diminished. In particular, we were pleased with better-than-expected economic data out of China, the success of the European Central Bank’s 3-year repo operation, signs that a disorderly default by Greece will be avoided, and indications that the sanctions on Iran might have only a limited impact on global oil prices. The global situation is still highly uncertain, but at least global investor sentiment is improving right now rather than deteriorating. Let’s hope that continues.

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