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June FOMC meeting: More gradual rate hikes than previously expected, once rate tightening begins

As expected, the Federal Reserve left its monetary policy stance unchanged at the 16-17 June meeting. According to the post-meeting statement,¹ the committee upgraded its assessment of economic activity, acknowledging some moderate economic expansion as well as some further diminishing of underutilized labor resources. Moreover, household spending was described as moderate and the housing market as having improved somewhat. In line with its April assessment, the committee characterised business investment and net trade as soft, probably reflecting the energy sector adjustment and the West Coast port strikes.

The FOMC downgraded its growth outlook for 2015, revising down its GDP forecast to 1.9% from 2.5% in March, and raising modestly higher the unemployment rate to 5.2-5.3% from 5.0-5.2% in March (Table 1). Additionally, the median fed funds rate projection for 2015 remained stable at 50-75bps, while the respective figure for both 2016 and 2017 fell by 25bps, to 150-175bps and 275-300 bps, respectively. The number of FOMC members expecting up to one rate hike by the end of the year has increased to seven from three in March. Hence, although the median projection for the fed funds rate at the end of 2015 was unchanged at 0.625%, the updated set of projections suggests that more FOMC members would like to ensure that the current positive momentum in the incoming data continues before the Fed embarks on a normalization of monetary policy.

Along these lines, Chair Janet Yellen adopted a more dovish than expected tone, emphasizing that the conditions for justifying monetary policy tightening are not yet in place. She repeated that the unemployment rate remains above NAIRU estimates and inflation below the committee's medium-term target of 2.0%.

We continue to expect the first fed funds rate hike in September, at the earliest. The Fed's revised projections for the future path of monetary policy suggest that once rate tightening begins, the pace of rate hikes will likely be more gradual than previously expected.

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¹ <http://www.federalreserve.gov/newsevents/press/monetary/20150617a.htm>

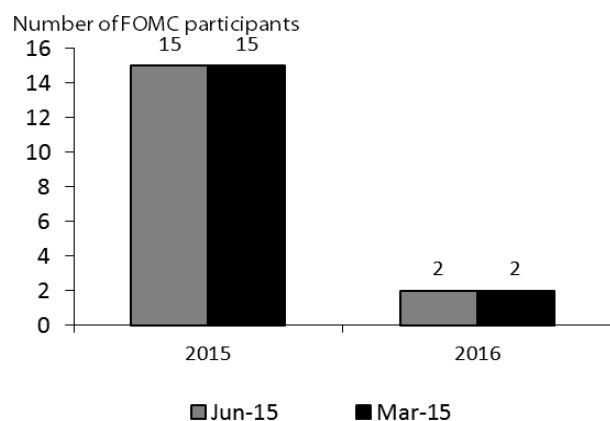
Table 1
Economic Projections of Federal Reserve Board Members and
Federal Reserve Bank Presidents, June 2015

USA	Central Tendency*			
	2015	2016	2017	Longer run
Change in real GDP	1.8 – 2.0	2.4 – 2.7	2.1 – 2.5	2.0 - 2.3
March projection	(2.3-2.7)	(2.3-2.7)	(2.0-2.4)	(2.0-2.3)
Unemployment rate	5.2 – 5.3	4.9 – 5.1	4.9 - 5.1	5.0 – 5.2
March projection	(5.0-5.2)	(4.9-5.1)	(4.8-5.1)	(5.0-5.2)
PCE inflation	0.6 – 0.8	1.6 - 1.9	1.9 - 2.0	2.0
March projection	(0.6-0.8)	(1.7-1.9)	(1.9-2.0)	(2.0)
Core PCE inflation	1.3 - 1.4	1.6 – 1.9	1.9- 2.0	
March projection	(1.3-1.4)	(1.5-1.9)	(1.8-2.0)	
Fed Funds Rate	0.25 – 1.00	1.25 – 2.50	2.25- 3.75	3.50 – 3.75
March projection	(0.50 - 1.25)	(1.50 – 2.75)	(2.50- 3.75)	(3.50 – 3.75)

*The central tendency excludes the three highest and three lower projections for each variable in each year.

Source: Federal Reserve, Eurobank Research

Figure 1: Appropriate Timing of Policy Firming in the US



Source: Federal Reserve, Eurobank Research

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