"Operating Under a Cloud of Uncertainty" December 14, 2016

As expected, the FOMC raised rates by 25 bps today, bringing the target range to 50-75 bps. What was surprising: **Despite virtually no changes to the participants' economic forecasts for GDP and inflation and the continued use of the word "gradual" to describe the pace of monetary policy adjustment, a third rate hike was penciled in for 2017.**

***Table 1.*** **Economic Projections of Federal Reserve Board Members and Presidents, December 2016**

| Variable | 2017 | 2018 | 2019 | Longer Run |
|---|---|---|---|---|
| **Change in real GDP, %** | 1.9 to 2.3 ≈ ↑ | 1.8 to 2.2 ≈ ↑ | 1.8 to 2.0 ≈ ↑ | 1.8 to 2.0 ≈ ↑ |
| September Forecast | 1.9 to 2.2 | 1.8 to 2.1 | 1.7 to 2.0 | 1.7 to 2.0 |
| **Unemployment rate, %** | 4.5 to 4.6 ≈ ↓ | 4.3 to 4.7 ≈ ↓ | 4.3 to 4.8 ≈ ↓ | 4.7 to 5.0 ≈ |
| September Forecast | 4.5 to 4.7 | 4.4 to 4.7 | 4.4 to 4.8 | 4.7 to 5.0 |
| **PCE inflation, %** | 1.7 to 2.0 ≈ ↑ | 1.9 to 2.0 ≈ ↓ | 2.0 to 2.1 ≈ ↑ | 2.0 ≈ |
| September Forecast | 1.7 to 1.9 | 1.8 to 2.0 | 1.9 to 2.0 | 2.0 |
| **Core PCE inflation, %** | 1.8 to 1.9 ≈ ↑ | 1.9 to 2.0 ≈ | 2.0 ≈ | n/a |
| September Forecast | 1.7 to 1.9 | 1.9 to 2.0 | 2.0 | n/a |
| **Fed Funds (average)** | 1.37% ↑ | 2.23% ↑ | 2.80% ↑ | 2.95% ↑ |
| September Forecast | 1.31% | 2.11% | 2.65% | 2.91% |
| **Fed Funds (median)** | 1.375% ↑ | 2.125% ↑ | 2.875% ↑ | 3.000% ↑ |
| September Forecast | 1.125% | 1.875% | 2.625% | 2.875% |

*Source:* Federal Reserve

*Note:* Excludes the three highest and three lowest projections for each variable in each year (except average and median Fed Funds rate figures, which include all participants.) Arrows (↑,↓ and ≈ ) indicate direction of change in forecast from September 2016 to December 2016. Real GDP and inflation projections are from Q4 of the previous year to Q4 of the year indicated. PCE inflation refers to the price index for personal consumption expenditures. Projections for the unemployment rate are for the average rate during Q4 of the year indicated.

In the Q&A session that followed today's statement, Chair Yellen was quick to point out that the three rates increases projected for 2017 represented a **"very modest adjustment"** made by only "some of the participants." Despite noting that the Fed was **"operating under a cloud of uncertainty"** given the lack of clarity on the policies of the new administration, she did suggest that some participants likely had incorporated assumptions regarding fiscal policy changes into their forecasts---"one of several factors" that would affect the speed of monetary policy tightening.

Chair Yellen did say that today's rate increase is "a reflection of confidence in the progress economy has made" even as **productivity growth has remained stubbornly low.** While she added that policies to "enhance education, training and workforce development" could all serve to boost productivity—as could public or private investment to enhance the quality of capital that workers have—she declared that she would *not* offer any fiscal policy advice, other than to say that **while "tax policies can" have the effect of raising productivity, the impact would "depend on specifics."** She did mention that debt/GDP ratios are expected to rise as the population ages—perhaps a cautionary note ahead of any deficit spending.

She also weighed in on financial regulation, stating that it is "important to relieve the regulatory burden on community banks and smaller financial institutions." She reiterated the independence of the Fed, and stated that she will serve out her four-year term. When pushed on equity market prices (the S&P 500 is up 13.6% YTD) she somewhat reluctantly noted that **equity market valuations** "remain within normal ranges." At least for now, the FOMC will have to wait and see—just like the rest of us.

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