US Federal Reserve: Hold the line

- **The US Federal Reserve (the Fed) has left the Fed Funds target range unchanged at 0% – 0.25%.**
- **While the Fed acknowledged the US economy was "expanding at a moderate pace", concerns remain for the outlook on inflation.**
- **Significantly, the Fed stated that "recent global economic and financial developments" could restrain economic activity and put further downward pressure on US inflation.**
- **The Federal Open Market Committee (FOMC) participants forecast the Fed Funds rate which is plotted in a chart that has come to be known as the 'dot plot'. The Fed's 'dot' forecasts for the Fed Funds rate do still imply one rate hike before year-end 2015 and a gradual normalisation path in the years ahead.**
- **We now expect the rate hike process to get underway at the December FOMC meeting, and continue to expect a move at every second meeting through 2016, with further tightening of monetary policy in 2017 and 2018.**

The Federal Open Market Committee (FOMC of the US Federal Reserve has, in line with consensus (but against our expectation) decided to leave the official Fed Funds target rate at 0% – 0.25%.

Although the Fed statement said the economy was expanding at "a moderate pace", there were now some downside risks to inflation.

The Fed twice mentioned the negative effects of the global economy and financial markets, stating that "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term."

In terms of forward guidance on policy, the Fed statement was unchanged stating that "the Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen some further improvement in the labour market and is reasonably confident that inflation will move back to its 2.0% objective over the medium term."

In her press conference, Fed Chair Janet Yellen left the door open for an interest rate rise this year, in either October (where a press conference would be called if needs be) or, perhaps more likely, in December.

The outlook for the Fed

Having made the decision to leave interest rates unchanged, the FOMC members have had to lower their expectations for the Fed Funds rate outlook, i.e. the 'dots'.

Importantly, the Fed's 'dot plot' includes one rate hike before the end of 2015, with the median 'dot' for year-end 2015 now at 0.4%, rather than 0.63% (previously).

By end 2016 the median 'dot' is at 1.4%, down from 1.625% in June.

By end 2017 the median 'dot' is at 2.6%, well down on the June estimate of 2.875%.

Further out, the long-term 'dot' forecast has been reduced to 3.5%, down from 3.75% previously.

These 'dot' forecasts, shown in the table below, form an important part of the Fed's communications strategy:

Fed rate median 'dot' forecast

Year end	2015	2016	2017	Long-term
Sept 15	0.4%	1.4%	2.6%	3.5%
June 15	0.63%	1.63%	2.88%	3.75%
March 15	0.63%	1.88%	3.13%	3.75%
Dec 14	1.13%	2.50%	3.63%	3.75%

Source: US Federal Reserve, 17 September 2015

In addition, 13 of the 17 members of the FOMC expect a rate hike in 2015, with three expecting the first move in 2016 and one in 2017.

Interestingly, one FOMC member actually has a 'dot' that is below zero in 2016, i.e. wanting a further rate cut, while Jeffrey Lacker, President of the Richmond Fed, dissented today and voted for a 25bp rate hike.

Revised economic forecasts

As per the usual quarterly pattern, the Fed has updated its economic forecasts. The changes to the economic projections are relatively minor, but nonetheless important.

- The Fed now expects an unemployment rate of 5% at year-end 2015, down from the previous forecast of 5.3%. The Fed then expects the unemployment rate to be 4.8% at year-end 2016, 2017 and 2018.
- The economic growth forecast for year-end 2015 has been revised up to 2.1% from 1.9% in the previous forecast in June.
- For 2016 the Fed now expects GDP growth of 2.3%, down a little from the June forecast of 2.5%. The 2017 growth forecast is now at 2.2%, from 2.3% previously, while the longer run forecast is unchanged at 2.0%.
- The inflation (Core PCE) forecast for 2015 as been revised marginally higher to 1.4% from 1.3%.