ECONOMIC UPDATE

REGIONS

March 15, 2017

March 2017 FOMC Meeting: FOMC Sticks To The Script

- The FOMC raised the mid-point of the Fed funds rate target range by 25-basis points, to 0.875 percent.
- The implied trajectory of the Fed funds rate is unchanged from the December 2016 projections.

Well, they told us it was coming and they did what they said they would do. The FOMC raised the mid-point of the Fed funds rate target range by 25-basis points to 0.875 percent. Perhaps the bigger question going into this month's meeting was whether or not the FOMC would, via their "dot plot," imply a more aggressive trajectory of rate hikes in 2017 than that implied by the December 2016 dot plot. They did not, nor did we expect them to do so. Judging by the post-meeting reaction in the financial markets, however, many market participants priced in such a change, as yields on U.S. Treasury securities fell as did the exchange value of the U.S. dollar. So, after over two years of not believing the FOMC would do what they said they would, market participants suddenly believed the FOMC would do more than they said they would. In any event, with the FOMC sticking, at least for now, to a slow but steady course, equity prices have continued their upward march.

There were few changes to the FOMC's assessment of current economic conditions. Economic growth is still described as "moderate" and job growth as "solid." One upgrade is the description of business fixed investment, now said to have "firmed somewhat" as opposed to being described as soft. While acknowledging inflation has moved close to the Committee's longer-run objective of 2.0 percent, it was noted that core inflation is little changed and continues to run "somewhat below" 2.0 percent. This nod to core inflation is both new and relevant. The FOMC is looking past the recent upturn in headline inflation fueled by higher energy prices and sees core inflation as the more meaningful gauge of underlying inflation pressures in the broader economy.

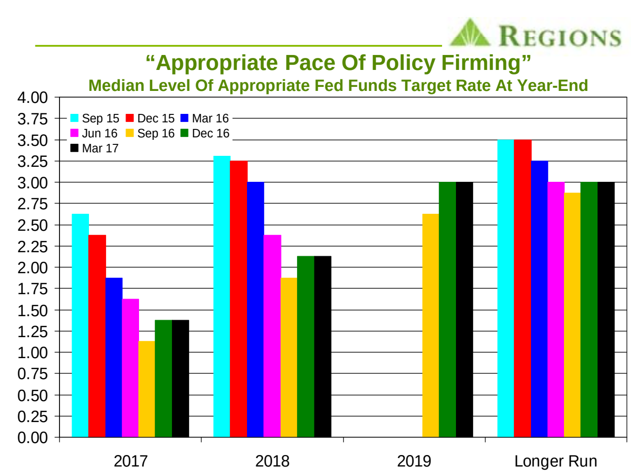
The FOMC also released the latest round of their economic projections, which show few changes from those issued in December. Real GDP growth is still, per the mid-point of the central tendency forecasts, pegged at 2.1 percent for 2017 on a Q4/Q4 basis, with a marginal increase to 2.05 percent in the forecast for 2018 and 2019 growth holding at 1.9 percent. The Committee's median estimate of longer run growth remains unchanged at 1.9 percent. FOMC projections of the unemployment rate remain centered on 4.5 percent, with the median estimate of the longer rate remaining at 4.75 percent. Aside from a very slight decline in the median estimate for 2017 there were no changes in the Committee's projections of either headline or core inflation.

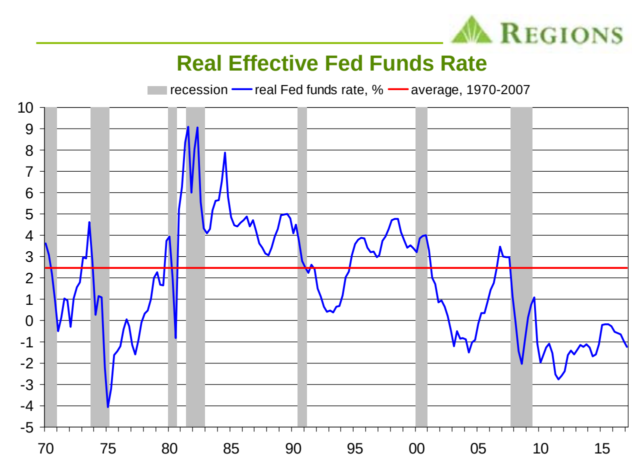
As to the FOMC's description of the path of rate hikes, past statements have said it expects economic conditions will "evolve in a manner that will warrant only gradual increases in the Fed funds rate" but today's statement removed the word "only." We saw this as not noteworthy but some analysts jumped on this as some sort of hidden message. In her post-meeting press conference, Dr. Yellen said to not overthink it, as it does not reflect any change in sentiment amongst Committee members.

Any such change in sentiment would have been reflected in the dot plot but, as noted above, today's plot implies the same trajectory of rate hikes as the December 2016 dot plot. In other words, a total of three 25-basis point funds rate hikes this year – including today's – followed by three more in 2018 and an additional 87.5 basis points worth of hikes in 2019. The median estimate of the neutral funds rate remains 3.0 percent.

This leaves the neutral value of the real funds rate at 1.00 percent, which as Dr. Yellen noted, is well below historical norms. This is a function of current trend rates of labor force and productivity growth. At present, however, the real effective funds rate is hovering around negative 1.0 percent, meaning monetary policy remains highly accommodative. Our view is that this is the primary motivation for the FOMC's recent change in tone and them moving "sooner rather than later," to borrow their term. Should growth and/or inflation pick up more than anticipated, moving today helps ensure the FOMC will not fall behind the curve on inflation while the implied path of rate hikes this year and next leaves a good deal of policy accommodation in place.

As Dr. Yellen noted today, monetary policy is not set in stone, and today's rate hike does not lock the FOMC into any particular path. The FOMC will adjust policy as warranted by the evolution of the data. It may, however, take the markets some more time to fully believe this.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com