ECONOMIC UPDATE
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June FOMC Meeting: Now That You Say It Like That, It Makes Perfect Sense . . .

- The FOMC announced no changes to current Fed policy but offered clarification as to how it sees its large-scale asset purchases evolving.
- The FOMC's central tendency forecasts for inflation in 2013 were marked down substantially.

To the surprise of no one, the FOMC announced no changes to current policy at today's conclusion of their two-day session. Any mystery surrounding this meeting involved the post-meeting policy statement, the FOMC's central tendency forecasts, and, most notably, Chairman Bernanke's press conference, at which he elaborated on the potential evolution of the Fed's large scale asset purchases while remaining adamant that this reflected no change to policy. There were also analogies between monetary policy and driving a car, and between monetary policy and landing on an aircraft carrier though it isn't clear to us if the car is landing on the carrier or we just missed something.

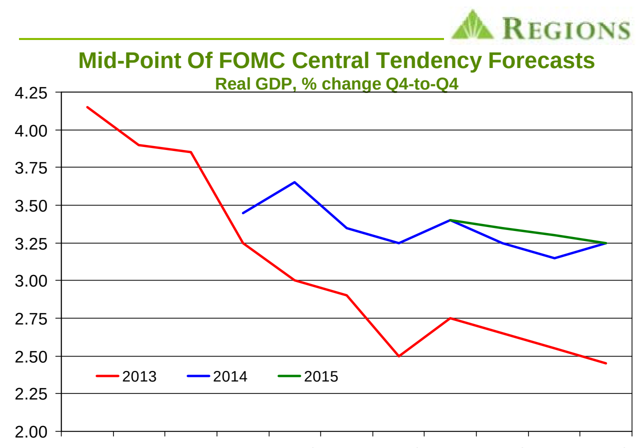
The Committee's assessment of current economic conditions was little changed, with a reference to "transitory influences" as holding inflation below the 2.0 percent target rate. One notable change is the acknowledgement that the downside risks to the outlook for the economy and the labor market have diminished, whereas in past statements the Committee has pointed to downside risks to the outlook.

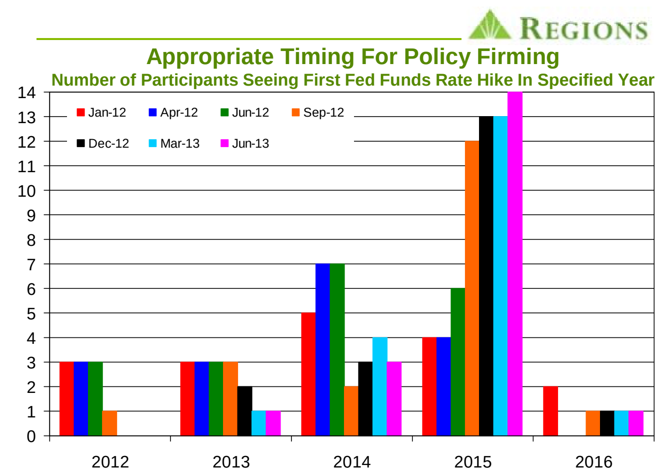
The most notable element of the post-meeting statement is the revelation that there were two dissents from the vote to keep policy unchanged. What makes this notable is that there were dissents from both sides of the aisle, with Kansas City Fed President George again dissenting out of concern over potential financial instability and inflation. At the same time, St. Louis Fed President Bullard dissented from the dovish side, believing the Fed's 2.0 percent inflation target must be defended from below as well as from above. President Bullard has expressed his view that low and falling inflation is grounds for the Fed to be more aggressive with its large-scale asset purchases.

The FOMC's central tendency forecast for 2013 real GDP growth was marked down yet again, albeit only modestly, with the central tendency growth rate now put at 2.45 percent compared to the prior projection of 2.55 percent. Far more significant was the markdown in the central tendency forecast for inflation, with inflation (as measured by the PCE deflator) now pegged at 1.0 percent and core inflation at 1.25 percent, compared to 1.50 percent and 1.55 percent, respectively, in the prior forecast. While the projection for the unemployment was also marked down, to 7.25 percent for a Q4 2013 average, given the persistent decline in the labor force participation rate, this is not necessarily reflective of significantly improved labor market conditions.

As was widely expected, Chairman Bernanke took care to stress the distinction between balance sheet policy, i.e., the size and rate of change of the Fed's balance sheet, and interest rate policy, i.e., changes in the Fed funds rate. As to balance sheet policy, Chairman Bernanke laid out a path on which asset purchases are dialed back later this year and ended in mid-2014 – as long as the economy evolves as expected. Specifically, the FOMC expects growth to gradually improve as fiscal drag progressively fades, and inflation to move closer to the 2.0 percent target. Still, the mid-2014 timeline is not set in stone but rather is dependent on the evolution of the data – as Chairman Bernanke put it, this is not a change in (balance sheet) policy but merely clarification as to how the Committee sees that policy playing out over time. For those looking for specific thresholds to which the course of asset purchases is tethered, there were none offered nor will there be. But the FOMC's view is the stock of assets on the Fed's balance sheet, not the rate of change, is the relevant yardstick of whether policy is accommodative – dialing down the rate of asset purchases is not a tightening of monetary policy according to this view, whether or not the markets agree.

Still, Chairman Bernanke again reiterated even when the asset purchases have run their course it will be a "considerable time" before the initial increase in the Fed funds rate. To this point, the vast majority of FOMC members still see that coming in 2015. All in all, Chairman Bernanke's statements were more expansive in terms of the anticipated path of the Fed's asset purchases, but it is clear, as the FOMC hoped all along it would be, movement along that path will be a function of how the economic data evolve over coming quarters.





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