ECONOMIC UPDATE

REGIONS

September 17, 2014

This Economic Update may include opinions, forecasts, projections, estimates, assumptions and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political and other conditions. There is no guarantee as to the accuracy or completeness of the Contents of this Economic Update. The Contents of this Economic Update reflect judgments made at this time and are subject to change without notice, and the information and opinions herein are for general information use only. Regions specifically disclaims all warranties, express or implied, with respect to the use of or reliance on the Contents of this Economic Update or with respect to any results arising therefrom. The Contents of this Economic Update shall in no way be construed as a recommendation or advice with respect to the taking of any action or the making of any economic, financial or other plan or decision.

September 2014 FOMC Meeting: Language More Dovish, Dots More Hawkish

- The FOMC announced it will reduce the pace of its monthly asset purchases to a rate of $15 billion per month.
- The FOMC offered "Policy Normalization Principles and Plans" but kept intact the forward guidance around the path of the Fed funds rate.

As was widely expected, the FOMC voted to further taper the pace of the Fed's monthly asset purchases to what will be a rate of $15 billion per month. What was less certain, however, is whether the Committee would alter the language in its assessment of the labor market and whether they would alter their forward guidance around the path of the Fed funds rate – they opted to do neither. The Committee also released their latest round central tendency forecasts for the paths of economic growth, the unemployment rate, and inflation as well as its projections for the appropriate pace of policy firming (the "dot chart").

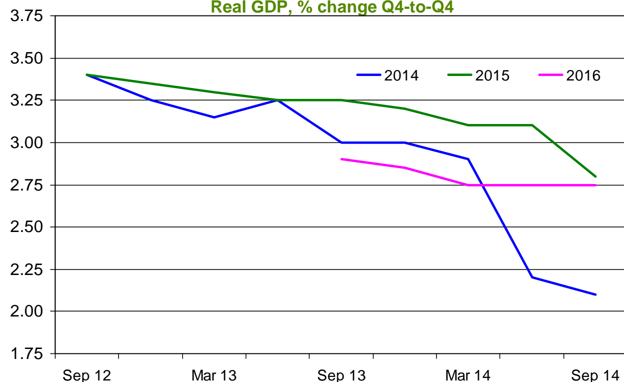
The FOMC's view of underlying economic conditions has not materially changed. While noting labor market conditions "improved somewhat further" the statement that "there remains significant underutilization of labor resources" remained in place. There were some who thought this would be stricken but in her press conference Chairwoman Yellen again stressed several metrics pointing to a high degree of labor market slack. One change the FOMC did make involved the assessment of inflation, with today's statement noting "inflation has been running below the Committee's longer-run objective" which is actually a reversion to the language used prior to July when the Committee said "inflation has moved somewhat closer to the Committee's longer-run objective." Dr. Yellen had noted what she considered a high degree of noise in the inflation data during the summer, and the more recent CPI data provide support for her view.

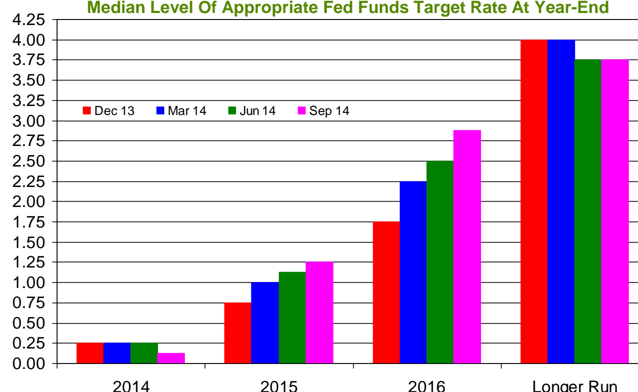
The FOMC also retained its forward guidance around the path of the Fed funds rate, specifically "it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends." Many had anticipated the Committee to rid itself of this phrase in today's statement, and its inclusion drew another dissent from Philadelphia Fed President Plosser and one from Dallas Fed President Fisher – perhaps more surprising is Cleveland Fed President Mester did not join them in dissenting given her statements to the effect this guidance was no longer appropriate.

The central tendency forecast for Q4/Q4 real GDP growth in both 2014 and 2015 was marked slightly lower in the latest round of projections from FOMC members. The midpoint for 2014 is now 2.1 percent (down from 2.2 percent in June) and the midpoint for 2015 is now 2.8 percent, falling below 3.0 percent for the first time since projections for 2015 have been offered. There were only marginal changes to central tendency forecasts for the unemployment rate and inflation.

Still, the FOMC's revamped "dot chart" got steeper in the latest round of projections, as seen in our rendition below. The change made in this round is the level of the "appropriate" funds rate is now reported in increments of 1/8 of a point to reflect the mid-point of what will be a target range for the funds rate. The more interesting point, however, is that the median appropriate level for the funds rate at year-end 2015 and 2016 is higher. Though Dr. Yellen downplayed this in her press conference, one intepretation is perhaps many FOMC members view much of the recent decline in labor force participation as structural, not cyclical, which would mean funds rate hikes would have to be more, for lack of a better term, aggressive than would be the case were cyclical forces behind the declining participation rate. At the same time, however, the median projection for the longer run funds rate target remained at 3.75 percent, having dipped to that level with the June projections. Again, this would be consistent with a structural decline in participation that led to a lower "speed limit" (i.e., potential growth rate) for the economy than had previously been thought to be the case.

In their statement on policy normalization principles the FOMC noted while they will maintain a target range for the Fed funds rate the interest rate on excess reserves will be the primary policy lever but that the overnight repo rate will also be used. The balance sheet will be pared down passively – no sign of asset sales – in a "gradual and predictable manner." There were no surprises here, but the principles offer a more formal discussion of how normalization will look, without of course offering any such specifics around the timing.





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