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Economics Group

Special Commentary

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New Year, New FOMC Voters, New Tilt?

A More Moderate Mix of FOMC Voters in 2015

The new year has been ushered in with widespread expectations that 2015 will be the year in which the fed funds target rate is finally lifted from its historic low. A new year, of course, also means a new batch of voters on the Fed's rate setting committee. While 2015 will see fewer turnovers in voting members compared to 2014, there will still be some significant changes. How might the annual rotation affect the timing and pace of policy tightening?

Last year brought notable turnover to the Board of Governors. In addition to Janet Yellen taking over as Chair as Ben Bernanke and Jeremey Stein departed, Stanley Fischer and Lael Brainard joined the Board of Governors. This year's changes to the voting group, however, will be highlighted by the typical rotation of regional Fed presidents who will, on net, bring a more dovish tilt (Figure 1). Emerging hawk Loretta Mester (Cleveland) and arguably two of the most hawkish regional presidents—Charles Plosser (Philadelphia) and Richard Fisher (Dallas)—will be rotating off. The only incoming voter with a hawkish record will be Richmond Fed President Jeffrey Lacker, who dissented at all eight meetings when voting in 2012 but appears more comfortable with the current stance of monetary policy than in years past. After the FOMC's most recent meeting in December, he stated that he "supports the characterization that [the FOMC] can be patient at this point."[1] With the FOMC at its last meeting laying the groundwork for tightening and inflation not an imminent threat, we expect Lacker to vote in line with the Committee at least through the early part of the year.

This year's voting group will be more dovish.

Figure 1

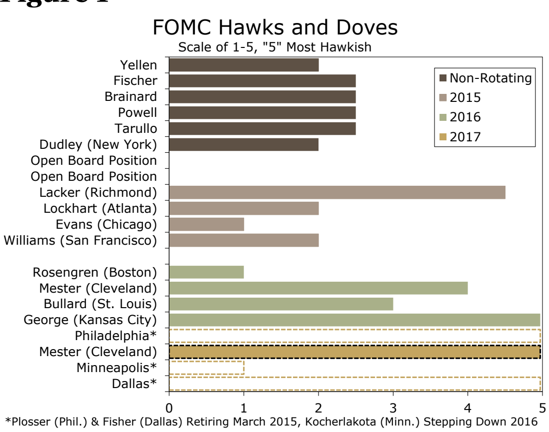
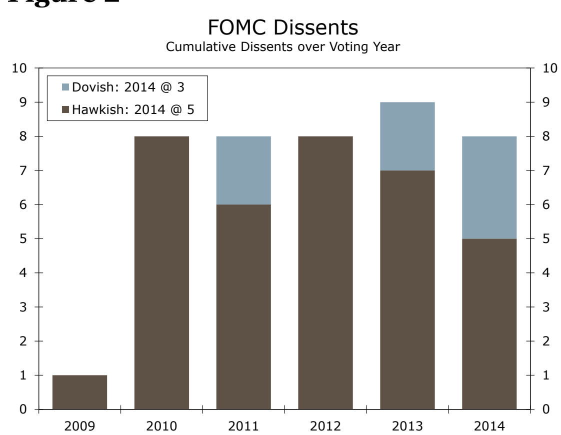


Figure 2



Source: Federal Reserve Board and Wells Fargo Securities, LLC

Also voting this year will be more moderate members, Presidents Dennis Lockhart and John Williams of Atlanta and San Francisco, respectively. Both supported the FOMC's steps to lower

[1] Interview with reporters following the Charlotte Chamber Economic Outlook, Dec. 19 2014.

long-term rates through Operation Twist and the launch of QE3 in 2012, voting with the committee at every meeting. Williams has taken a more upbeat tone on the economy in recent months. Although still "in no rush to tighten," he sees the economy reaching full employment by the end of 2015 or early 2016 and underlying inflation trends only "a little bit below our 2 percent goal" and likely to move back to target.[2] As a result, June seems like a "reasonable" time to think about liftoff, although he would not rule out tightening to begin later in the year.[3]

Meanwhile, Lockhart remains wary of moving too early. He also sees mid-2015, or quite possibly later in the year, as appropriate for raising rates given that inflation is still indicating only "lukewarm" demand.[4] However, having stated a desire to take a "whites of their eyes" approach on the FOMC's mandates—seeing improvement in the labor market and inflation, not just expecting it—he may favor later in the year when it becomes clear that lower oil prices have not affected core inflation. While Lockhart and Williams have indicated the economy may be ready to begin policy normalization this year, each has stressed that the pace of tightening should be gradual.

Dovish dissents may very well outnumber hawkish dissents in 2015.

The fourth regional president to vote this year will be Charles Evans of Chicago, who will take up the role of uber-dove from Minneapolis Fed President Narayana Kocherlakota. Similar to Kocherlakota, Evans is concerned that inflation will not return to 2 percent within a reasonable amount of time and would be comfortable with an overshoot of inflation after running below target for some years now. Whereas the FOMC indicated in its last statement that it "can be patient," President Evans has expressed that the Committee "*should* be *exceptionally* patient" (emphasis ours), as a policy mistake at the zero lower bound is particularly difficult to remedy.[5] Evans did not dissent in his last term as a voter in 2013, but dissented twice in 2011 when he believed the FOMC should provide accommodation beyond Operation Twist. Barring no significant changes to the economic outlook, we see him as the most likely dissenter this year and for dovish dissents to outnumber hawkish dissents in 2015—a notable reversal from years past (Figure 2).

Some Noisy Birds Will Be Leaving the Nest

While dissents can make headlines, what is perhaps more important for the Fed is the variety of views held around the table that over time can shape the thinking of the policy setting committee. To this end, it is important to note that not only will perennial hawks Plosser and Fisher not be voting this year, but they both also will be retiring in March.[6] A few presidents with hawkish records will remain (Lacker, Mester and Esther George of Kansas City), but the contingent may be smaller and less vocal without Plosser and Fisher, depending on who each district's board selects as a replacement.

On the other end of the spectrum, and a little further down the road, Kocherlakota has announced he will not be seeking reappointment as president of the Minneapolis Fed when his term is up in February 2016. Kocherlakota was considered a hawk early in his tenure, dissenting twice in 2011 in opposition of Operation Twist alongside Plosser and Fisher. Since then he has changed his view on how much weakness in the economy has been due to structural versus cyclical factors and has become increasingly concerned with low inflation; in 2014, he dissented three times.

Will a More Dovish FOMC Even Matter in 2015?

Although this year's rotation leaves the voting group with more dovish leanings, even non-hawks are discussing the economy's progress and the need to begin normalizing rates this year. Assuming three of the four highest submissions on the December "dot plot" are from non-voting hawks (perhaps Plosser, Fisher and George) and one of the lowest is from Kocherlakota, the median estimate of the appropriate range for the fed funds rate at the end of this year is 0.75-1.00 percent (Figure 3). This would imply that the FOMC would begin to raise rates in

[2] Bloomberg Radio interview, Dec. 19, 2014.
[3] Ibid.
[4] Speech at Mississippi Council on Economic Education, Sept. 25, 2014.
[5] Speech at National Council on Teacher Retirement 92nd Annual Conference.
[6] Plosser's last meeting will be Jan. 27-28 while Fisher's last meeting will be March. 17-18.

September if moving at 25 basis point increments, or earlier if the Committee wanted to hike more gradually than it has in the past. We anticipate the FOMC to announce its first rate hike in June and for the target rate to end the year at 0.75-1.00 percent.

Figure 3

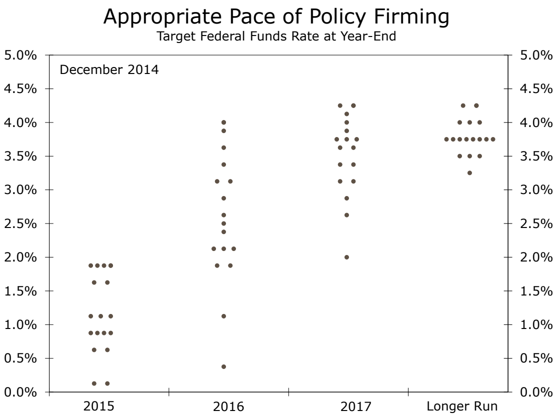
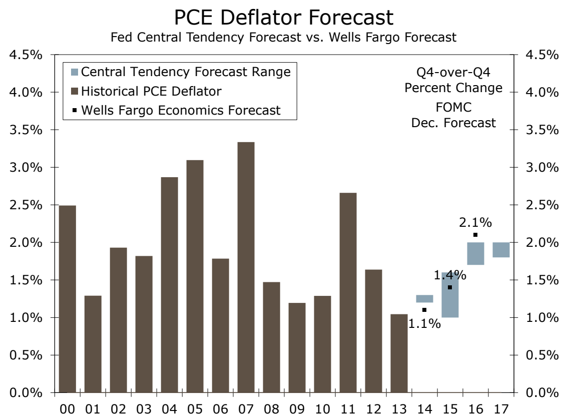


Figure 4



Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities, LLC

To be sure, 2015 will not be without risks to the FOMC's mandates and the broader economy. Falling oil prices are delaying what has already been a challenging return to the Fed's 2 percent inflation target (Figure 4). Meanwhile, sluggish growth overseas is leading to even more accommodative policy in some of the world's biggest economies, which, in turn, is putting downward pressure on U.S. rates and strengthening the dollar. These conditions, along with a more dovish group of regional bank voters, lead us to believe that the risks to our call for the Fed to begin tightening in June are skewed toward a later date for liftoff.

Even with a generally more dovish voting group, we do not expect any change in the FOMC's policy course.

That said, Fed Chair Yellen stood firm at the December press conference in her view that the effect of lower energy prices on inflation should prove temporary. She also stressed that monetary policy works with a lag, which supports our view that the Committee will not wait for inflation to reach 2 percent before raising rates. The Committee looks to generally be behind her on this issue, with the meeting minutes noting that policy normalization could begin even if core inflation remained near current levels (1.4 percent), so long as inflation looked set to return to target over time. The December meeting minutes also showed that the FOMC views slower global growth next year as a downside risk to the outlook, but that the risks of stronger-than-expected U.S. growth due to domestic factors (strong payrolls, lower energy prices and improving confidence) were nearly as large. Therefore, even with a voting group that has a generally more dovish outlook than last year, we do not expect any change in the FOMC's policy course absent any significant changes to the economic outlook.

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