MarketNews international

FOMC Preview: All Eyes On Economy

No Change Expected To Policy Guidance In FOMC Statement

By Brai Odion-Esene -- April 19, 2012

WASHINGTON (MNI) - Policy guidance from the Fed's rate-setting Federal Open Market Committee next Wednesday is likely to remain unchanged following its two-day meeting, with many Fed watchers focusing on members' economic and interest rate projections for any hints of a shift in their outlook for the economy.

The FOMC will meet April 24-25 in Washington, after which -- in addition to the usual statement -- the Fed will release participants' economic forecasts and expectations for the future path of the federal funds rate.

Wells Fargo Chief Economist John Silvia said he does not see Federal Reserve officials changing much at the meeting, as it appears that "things are going their way," albeit not at the pace officials would prefer.

The FOMC, he told MNI, is in a situation where the outlook is for moderate economic growth -- consistent with their view -- and inflation staying within their target.

"The jobs market seems to have stabilized ... . I don't think the inflation numbers have bothered them, so I don't see that there is a big case for them to make a lot of changes at this point," Silvia said.

Credit Suisse Economist Dana Saporta agreed, telling MNI the FOMC statement is likely to provide little new information, "primarily because I think the committee itself is undecided at this point about its next steps."

"I think to the extent that there will be new information coming from the FOMC on April 25 it probably would be in the economic and federal funds rate projections," she said.

"You would think they would change their forecasts," Saporta continued, noting for example that the FOMC currently forecasts the unemployment rate coming in between 8.2% to 8.5% by end of this year, "and we are already at 8.2% in March."

"Similarly for 2013 the range was 7.4% to 8.1%, that range will probably be moved down," she added.

The question is if the economy unfolds as the FOMC's new projections suggest, "will it become increasingly difficult for this late-2014 language to hold or whether the Fed will have to start thinking about adjusting that," she said.

Such thinking is premature at this point, however, Saporta said, as it remains to be seen if second quarter data shows a slowdown as the weather effects from Q1 start to wear off and if gasoline prices have a dampening effect on consumer spending.

The Fed is trying to remain flexible, Silvia said, although the balance of the evidence suggests the economy continues to improve.

The key will be the Fed's assessment of the economy, he said, "that really is the driving factor."

"At this particular point I believe the actual economic expansion is developing its own legs in the private sector," George Mokrzan, senior economist with Huntington National Bank, told MNI, and there is less stress at the state and local government level.

So with U.S. economy improving, aided by low interest rates, "the role for procyclical stimulus is ebbing," Mokrzan said.

"I think the Fed right now is in a wait and see mode," **Bernard Baumohl, chief global economist for the Economic Outlook Group,** told MNI.

He pointed to economic data indicating some strength in the U.S. economy, which has then been countered by recent signs of, perhaps, some weakening.

These 'ups and downs' signals mean the Fed is taking a backseat until they get a clearer sense as to whether the economy is improving or markedly slowing again, **Baumohl** said.

Silvia said, however, that he does not believe the Fed will have the luxury of waiting until late-2014 before raising rates because of inflation.

"In the future I don't think the inflation numbers will come down, I think you are going to see persistent inflation numbers around 2% to 2.5%," Silvia said. "It's not going to open up a door for the Fed to really wait that long."

He added that a steeper yield curve -- with the market viewing high inflation, large deficits and a growing economy as reasons to exit Treasuries -- will also force the Fed to act and hike rates.

"So I don't think you are going to make it to 2014 with no change in the federal funds rate," Silvia said.

Saporta said it is likely that Bernanke, and the voters on FOMC closest to him in thinking, "will probably argue for preserving the late-2014 policy guidance at this time."

Speaking to reporters after a speech to the National Economists Club in Washington on April 12, Philadelphia Federal Reserve President Charles Plosser said the Fed has backed itself into a corner with regards to its declared expectation that interest rates will likely stay low through 2014.

He noted that FOMC participants' projections of the likely future path of monetary policy, which will be published Wednesday along with participants' economic forecasts, is more informative regarding how policy will evolve.

"If you are really trying communicate clearly about how policy is evolving, I believe the so-called 'dot chart' can be very useful and informative about offering information about forward guidance," Plosser said. And as it evolves over time, "it's going to reveal views about how the committee's views are evolving."

"We could have utilized that as a way to help us out of this calendar date problem," he said. Instead, "we've still got to face this at some point."

Saporta noted that with the FOMC's projections for the unemployment rates, released after its previous two-day meeting in January, proving to be a little too pessimistic, "the markets will be looking intently to see whether there's been any shift in thinking among the individual FOMC participants on the appropriate timing of policy firming."

So while the 'dot' chart -- showing participants expectations for when the first rate hike -- may not shift, if it does "it probably would be in the more hawkish direction," she said.

"The only change you might see in those dotted charts might be one or two members of the FOMC who are going to probably argue that we ought to raise interest rates sooner than 2015," **Baumohl** said.

And with the recovery looking like it is gaining a little bit more traction, "there may be some sense that maybe the Fed should consider raising rates before 2015," he added.

The minutes from the March FOMC meeting show that "While a few participants indicated that their expectations for real GDP growth for 2012 had risen somewhat, most participants did not interpret the recent economic and financial information as pointing to a material revision to the outlook for 2013 and 2014."

Baumohl said any change to the economic projections of FOMC participants would towards "a bit more" of an optimistic outlook, but cautioned that any change would so marginal as to not be really significant.

In the Beige Book prepared for the April FOMC meeting, the Fed noted that the U.S. economy continued to expand at "a modest to moderate pace from mid-February through late March."

This assessment will not be enough to warrant any change in the FOMC's central tendency forecasts, **Baumohl** said.

Bernanke will hold a news conference Wednesday after the meeting, and Saporta cautioned that there is always the risk he will say something unexpected.

"We'll be listening closely to see if his commitment to the late-2014 policy guidance is wavering at all," or if he indicates that he favors additional monetary stimulus later this year.

"Unfortunately neither of these scenarios seem very likely to us," she said.

In the projections released after the January meeting, FOMC participants cut their forecasts for growth and the unemployment rate this year, as well as their inflation outlook.

The central tendency for 2012 GDP was revised to 2.2%-2.7% from their previous estimate of 2.5%-2.9%. The central tendency for unemployment was 8.2% to 8.5% from 8.5%-8.7% after the November FOMC. The band for PCE inflation this year was shifted to 1.4% to 1.8% from 1.4% to 2.0%.

And based on members' FFR projections, MNI calculated that the FOMC sees the fed funds rate averaging 0.35% in 2012, 0.56% in 2013, and rising to 1.07% at the end of 2014.