FOMC Meeting 6-15-16

- The central bank has decided to stand pat for now, but its median forecast expects two hikes during the remainder of this year assuming incoming data support. There are too many uncertainties to justify pulling the trigger at the June meeting. It is concerned about the employment picture even though economic growth has picked some steam. The FOMC wants to make sure that the surprisingly weak payroll number for April is a temporary phenomenon and not a harbinger of a weaker economy to come.

- Another major concern is what could happen across the Atlantic even though it was not specifically mentioned in the statement. The latest polls point to Brexit. Janet Yellen has said that if the British decides to leave the European Union, it “could have significant repercussions” in Europe as well as in the United States. In the short run, confidence on both sides of the Atlantic could be shaken leading to high volatility in the financial market as uncertainties mount. Beyond the short-term, economic growth in Europe and the U.S. could be hurt in part because of disruptions in trade flows.

- There have been indications that the inflation rate is making slow progress toward the goal. Responding to the tightening labor market, wages have risen at a faster pace recently. Import prices are accelerating adding to the inflationary pressure.

- However, the FOMC has acknowledged that the inflationary pressures and expectations are below target. The Fed’s favorite inflation indicator, PCE, has remained below the target rate of 2 percent for the past four years. There is little chance that the 2 percent goal will be reached in the near future even though it expects the target will be reached in the medium-term.

- The Fed officials are thinking how high the federal funds rate should rise in the long run. It has pared back its economic growth projections for the next couple of years. The inflation-adjusted natural rate, which balances savings and investment, is not too far above zero. This is one of the reasons Yellen has repeatedly pointed out that the trajectory of the rate rise will be slow and gradual.

- The balance of risks for economic outlook has not changed. Stronger spending, modestly higher inflation, a solid housing market and low layoffs show an economy which is improving as evidenced by the improved expectations for the second quarter GDP. However, the latest economic numbers including the soft jobs report for May present a complicated picture to the Fed officials. In addition, the global economy continues to suffer from turbulence.

- The officials have decided to strike a cautious balance holding the benchmark short-term interest rate at the current level.