December 15, 2023

FOMC Holds in December, Remains Committed to Bringing Inflation Down to 2%

Transcript

Kathleen Navin: Welcome to this edition of *Take Five with the St. Louis Fed*. I'm Kathleen Navin, Senior Business Economist, and today I will be discussing the latest FOMC meeting that took place on December 12 and December 13. At this meeting, the Federal Open Market Committee maintained the target for the federal funds rate at a range of 5.25 to 5.5%. In addition, there were no changes to current Federal Reserve balance sheet policy, where the reduction in security holdings continues as previously announced. Overall, the Federal Reserve's balance sheet has declined by roughly $1.2 trillion since quantitative tightening began last year. The current stance of monetary policy is viewed as restrictive and should be putting downward pressure on economic activity and inflation. And indeed, the FOMC remains strongly committed to bringing inflation back to the 2% objective. As Chair Powell noted during the press briefing, "We are committed to achieving a stance of monetary policy that is sufficiently restrictive to bring inflation sustainably down to 2 % over time and to keeping policy restrictive until we are confident that inflation is on a path to that objective."

In addition, at this meeting we also received updated projections known as the Summary of Economic Projections, which were last released in September. So here we have a chart of real GDP growth showing the revision from September to December. In December we have the dark maroon color, and we see that the median projection was revised up to 2.6% for 2023. Now, this is in response to stronger-than-expected data that occurred between September and December, and really, when we look back, overall, 2023 did surprise to the upside. When we think about this time last year, we saw a lot of private forecasters expecting a recession to take place sometime in 2023, and that did not happen. We saw the economy was more resilient than expected, but we do see in this latest set of projections that it's still the case that there is an expectation for the economy to slow, and we see that for 2024 the median projection was revised to 1.4%. Now, over the next few years following, the median projection will firm, and here we see that it firms to 1.8% in 2025 and then further to 1.9% in 2026.

Now, consistent with this stronger economy, what we see is on the unemployment rate that that has also surprised to the more positive side. The unemployment rate, currently at 3.7%, still indicates a very tight labor market, though Chair Powell did note in his press briefing that we are still seeing the labor market coming back into better balance, which is what we would want to see in that objective to get inflation back to the 2% target. What the

forecast shows is for the unemployment rate to rise gradually to 4.1% over the next year, where it remains through the remainder of the forecast.

And when we turn now to inflation, on headline PCE inflation, the median projection is for 2.8% in 2023. This was revised down from the September set of projections. The median projection is then for headline PCE inflation to moderate further to 2.4% in 2024 and 2.1% in 2025 before reaching that 2% objective in 2026. When we look at headline inflation and then remove the more volatile components of food and energy, we see here we have core PCE inflation, and just like we saw in headline inflation, the committee had a downward revision for 2023, and that median projection is now for 3.2% in 2023, down from 3.7% as recently as September. Inflation is then expected to moderate further, with core PCE inflation reaching 2.4% in 2024, 2.2% in 2025, and then reaching 2% in 2026.

Now, putting these forecasts together, essentially, each committee participant will look at the forecast and then determine the appropriate path of monetary policy consistent with that forecast. And then, looking at the median projection from that set of forecasts, we have this chart. So this is the federal funds rate median projection. We see that relative to September, there were downward revisions in that path. We know that at the December meeting there were no additional rate hikes, so ending the year at 5.4%, and then in this current set of projections, we see three rate cuts expected to occur in 2024, reaching 4.6, and then additional rate cuts as the Federal Reserve returns interest rates back toward their levels expected in the long run, gradually removing that restrictive stance.

And to get a sense of how restrictive policy is, it's also helpful to look at the real federal funds rate, which essentially subtracts out inflation from the nominal federal funds rate. Here we see in the dark maroon color the latest projection for 2023 is implied to be a gradual downward movement from 2.6% to 2.2% and then further moving back to that longer-run real federal funds rate of 0.5%. Now, we see here that gradual removal of restriction is a little different from what we had in September, where that restriction actually was expected to move up in 2024 and then move down. So now we're just gradually removing that over the next few years in these projections.

Now, markets responded quite a bit to the latest FOMC meeting, and their expectations are important, as they get priced into Treasury yields and other features like that in financial markets, so we do want to pay attention to these. What we see here is that there's been quite a lot of shifting going on, even before the December meeting. Between the July and September meeting, we saw that markets began to expect a much higher federal funds rate. Higher for longer became the kind of phrase that we were hearing a lot about. After the November announcement of the FOMC, we saw a partial reversal, where markets expected rate cuts to begin a bit earlier and then continue. But what we really saw was, after the December meeting, a much larger shift toward an earlier and earlier rate cut. So, between the

beginning of the week and then December 13, markets moved from expecting the first rate cut to occur in May to then March, and then we see that by the end of 2024 markets are expecting a much lower federal funds rate than was implied in the December Summary of Economic Projections. So, we'll be keeping an eye on these market movements, but just something to, you know, consider is this difference between the SEP and market expectations did move quite a bit after the December meeting.

But we also want to keep in mind that these are projections when we're talking about the Summary of Economic Projections, when we're talking about the dots plot, and that we want to keep in mind that these forecasts, you know, they could be updated as data come in and as expectations change. And as Chair Powell summarized, "While we believe that our policy rate is likely at or near its peak for this tightening cycle, the economy has surprised forecasters in many ways since the pandemic, and ongoing progress toward our 2 percent inflation objective is not assured. We are prepared to tighten policy further if appropriate." And so, keeping these things in mind as we look at all of the data coming in between now and the January meeting will be very important, and that concludes this *Take Five with the St. Louis Fed*. Thank you so much for joining us.

(END OF RECORDING)