Take 5 Five
WITH THE ST. LOUIS FED

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FOMC Holds Steady in September; Commits to Move Carefully Going Forward

Transcript

Kathleen Navin: Welcome to this installment of *Take Five with the St. Louis Fed*. I'm Kathleen Navin, senior business economist and, today, I will be talking about the latest FOMC meeting that took place on September 19 and 20. At this meeting, the FOMC unanimously decided to maintain the Federal Funds target at its current range of 5¼% to 5½%. In addition, we received updated economic projections—otherwise known as the Summary of Economic Projections or the SEP for short—which showed stronger growth was expected this year and next, as well as a lower unemployment rate, relative to the June set of projections. The median forecast is for PCE inflation to return to 2% by 2026, meeting the Fed's goal of 2% inflation. The updated dots plot shows the majority of FOMC participants view one additional rate hike this year occurring at either the November or December meeting, as appropriate, given the updated projections.

In the discussion of the decision to maintain the current stance of policy, Chair Powell noted in the press briefing, "Looking ahead, we are in a position to proceed carefully in determining the extent of additional policy firming that may be appropriate. Our decisions will be based on our ongoing assessments of the incoming data and the evolving outlook and risks." So speaking of the outlook, let's take a closer look at those latest projections.

Here we have real GDP growth. Looking at the median projection of FOMC participants, we see that the Committee now looks for 2.1% GDP growth this year, which is an upward revision from the latest set of projections in June; and then that should moderate to 1.5% in 2024, also an upward revision relative to June. After 2024, real GDP growth is expected to firm back to the longer-run estimate of 1.8% by 2025. Consistent with the upward revision to GDP growth in the near-term forecast, forecasts for the unemployment rate were revised lower. Here we show the median projection for the unemployment rate—which currently at 3.8%—is expected to rise very gradually to 4.1% by the fourth quarter of 2024, where it remains through 2025, before easing slightly to 4% by 2026…which is consistent with that longer-run estimate of the FOMC.

Now, we saw upward revisions to GDP growth, downward revisions to the unemployment rate; but turning now to inflation, we see very little changes relative to recent projections. Here, for the September set of projections, we see that the Committee median

projection is for PCE inflation to be 3.3% this year, before easing further to 2.5% in 2024, 2.2% in 2025 and then 2% in 2026, meeting that inflation objective. Removing the volatile components of food and energy from those inflation measures, we have core PCE inflation for which we also received updated projections. Here we see the median projection is for 3.7% core PCE inflation in 2023, and then a moderation to 2.6% in 2024, 2.3% in 2025, and then further to 2% in 2026. Now, when we think about our forecasts to this point, we've seen higher GDP growth, lower unemployment rate, but a similar path for inflation relative to recent forecasts.

Now, to kind of make sense of this, it's very helpful to look at the appropriate path of policy that FOMC participants expect to, you know, be in line with this forecast. Here we have the Federal Funds rate meeting projection. We see as mentioned earlier, that one more additional rate hike this year is expected as of these projections; so getting to that peak of 5.6% in 2023, and then we have rate cuts begin in 2024, and then continue into 2025 and 2026. Now the news around these latest projections is focused on how they compare to June. We see that the path for the Federal Funds rate is now expected to be higher for longer with these upward revisions to the path for 2024 and 2025. So for example, now, this path shows two rate cuts in 2024. Previously, as of June, it was at four rate cuts. So we see that rates are expected to be higher for longer, given that stronger forecast for GDP growth that we saw earlier.

Now it's also helpful to think about real interest rates in this environment, and this was actually quite a bit of the discussion of the latest press briefing with Chair Powell. What I've done on the next slide is look at the real Federal Funds rate, and I calculated this using the nominal Federal Funds rate and headline PCE inflation from the latest projections. What we see here is that, of 2023, we have a positive real Federal Funds rate expectation that's higher than in the longer run. This is consistent with a restrictive stance of monetary policy. We see that, in 2024, it actually becomes more restrictive; helping bring inflation down, back toward that 2% objective. And then, we see that the restrictive stance becomes less so in 2025 and 2026. Now looking at these projections is very helpful, but it's also helpful to look at what the market is expecting. What I show here is the FedWatch Tool from the Chicago Mercantile Exchange, the results around the time of each of the last few meetings. What we have noticed is that market expectations have moved much higher relative to where we were in June and even July. They are much closer to this latest set of FOMC projections for the Federal Funds rate at the end of 2023 and 2024. So, overall, markets are expecting rates to be higher for longer.

Now, in the discussion of this forecast, it's very important to keep in mind that these are forecasts, and there is still a lot of risk around the outlook. We know that those higher risks can create some uncertainty around the forecast, and some of them include things such as the recent increase in oil prices, a potential government shutdown, the United Autoworkers

strike, student debt…and these are just to name a few. And the time between now and the November meeting is really going to allow policymakers the ability to assess the impact of these developments, as well as other developments, and then continue monitoring economic data…also banking data, financial data…and that's going to allow them to determine, you know, what is the progress made toward the 2% inflation objection and what does that mean for policy going forward?

This concludes my comments on the latest September FOMC meeting, and I'll see you next time. Thank you.

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