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Economics Group

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FOMC: Sleuthing For Clues—And a Conclusion

Today's FOMC statement highlights the importance of deducing reasonable conclusions based upon limited information. Consider this detective work for economists. Information is imperfect but insights mandatory.

Well, My, My, My—Joe Kenda

"Near-term risks to the economic outlook have diminished." So now it appears we are moving closer to a FOMC move either in September, but in our view, more likely in December. The FOMC statement begins with the claim that the "labor market strengthened and that economic activity has been expanding at a moderate pace." There is a reference to "some" increase in labor utilization. As illustrated in the top graph, these comments are consistent with steady, but neither faster nor slower, growth in the economy and the labor market in the next 6-9 months, which is in line with the limits of a reasonable forecasting horizon. For all of 2016, we are forecasting a 1.9 percent pace of real growth in the economy—a moderate pace indeed.

Just One More Thing—Columbo

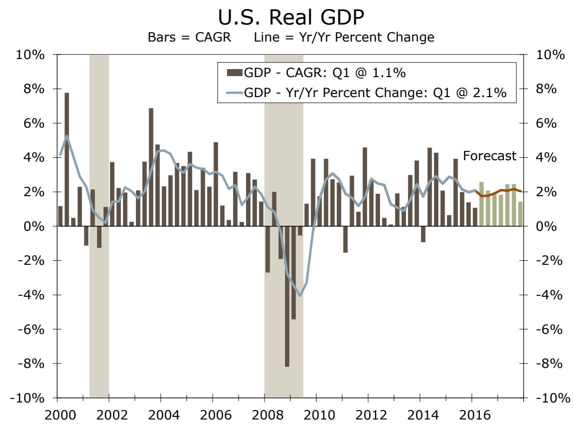
Inflation remains that "one more thing" that is missing to prompt acceleration in FOMC moves. The FOMC asserts that "inflation is expected to remain low over the near term....but to rise to 2 percent over the medium term..." This rise has remained elusive. Since 1991, inflation has averaged a bit below the 2 percent target—this is not your grandmother's inflation. While the inflation data do suggest an increase year-over-year, our expectation is that inflation will not hit 2 percent until early/mid-2017.

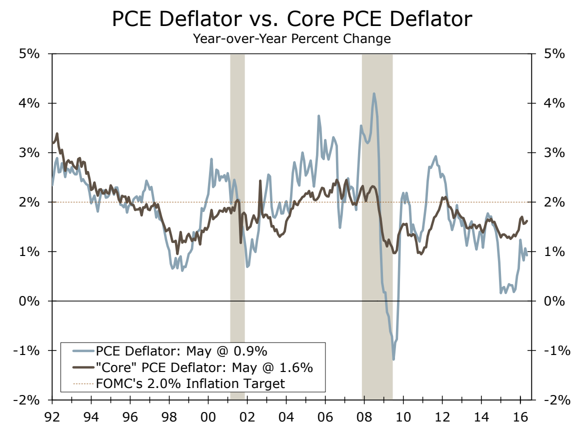
Moreover, the model for inflation acceleration remains unclear. Certainly the unemployment rate has declined to a near-full employment level, but the acceleration in wages remains modest at best compared to earlier cycles as we have noted previously (please see our most recent employment report, available on our website and upon request).

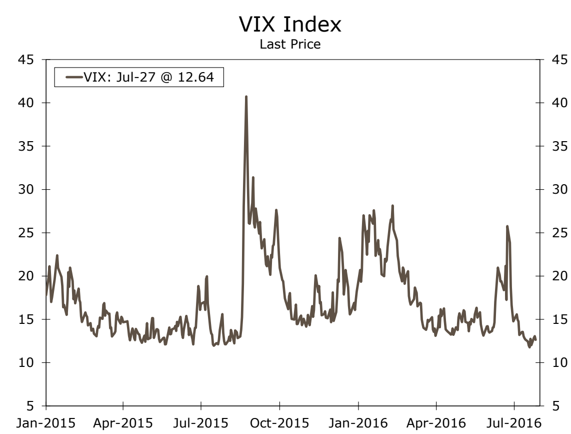
Whatever Remains, However Improbable, Must Be the Truth–Sherlock Holmes

So what gives? "This assessment will take into account...readings on financial and international developments." Here we have now the third leg of the monetary policy stool that has stood outside the traditional full employment/inflation duality of the monetary policy mandate. This third leg has appeared/disappeared/reappeared in FOMC statements over the past year, much as a suspect in a good detective show.

Unfortunately, assessing what is the character of "international developments" specifically is very difficult, like an intriguing suspect. Do we measure GDP? How about sentiment or market volatility? This international factor reemphasizes the importance of imperfect information and making guesses on the path of many economic and financial developments outside the bounds of the domestic economy. For us, we will go with volatility since that appears, post-Brexit, to be the one factor that raises the risk profile—like walking down a dark alley at night.







Source: U.S. Department of Commerce, Bloomberg LP and Wells Fargo Securities

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