The Daily Dish

Insights from the Fed Meeting

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Eakinomics: Insights from the Fed Meeting

The Federal Open Market Committee (FOMC) — the policymaking body for the Federal Reserve System — concludes a two-day meeting today. It is widely anticipated that the Fed will hold steady its policy interest rate (the federal funds rate). But even if the fed funds rate is unchanged, there is a lot to be learned today.

To begin, how does the Fed plan to communicate about the economy and future policy? There have been missteps on two fronts recently, with the equity market throwing a fit in December over the perception that the Fed would not be responsive to economic conditions. Fed officials have subsequently emphasized that they have the luxury to be patient in normalizing interest rates — hence the pause today — and that the size and pace of the final steps will depend on the economy. Good; it just should not depend exclusively on the stock market. In the past 40 years there have been 29 bear market corrections but only 5 recessions. The former should be largely ignored in favor of mitigating the chances of the latter.

Second, the Fed needs to communicate its desires for selling off the portfolio of Treasuries and mortgage-backed securities. Running down the portfolio pulls funds out of the financial markets and is a second kind of tightening. What is the target for the portfolio? $4 trillion? $3.5 trillion? And how fast will the Fed try to hit that target?

In both cases, the answers will depend on the projected strength of the economy and anticipated inflation. The Congressional Budget Office (CBO), for example, recently projected: “CBO expects the Federal Reserve to continue to raise the target range for the federal funds rate (the interest rate that financial institutions charge each other for overnight loans of their monetary reserves) in 2019. In CBO’s projections, the rising federal funds rate helps to push up other interest rates in the economy, which, in turn, helps prevent inflation from rising much above 2 percent for any extended time period.” Does the Fed agree about an inflation risk? Or, is inflation contained and growth continuing apace? Or, has the weakness in housing and business fixed investment migrated into the household sector and put solid growth at risk? These are the core issues facing the Main Street economy.

Finally, the meeting allows another opportunity to take the pulse of the relationship between the president and the Fed. If the Fed singles out tariffs, trade wars, and government shutdowns as significant impediments to growth, will the president resume his public attacks on Fed policy and personal attacks on Chairman Powell? Or will the prospect of no rate increase buy at least temporary peace?

Those are four interesting questions — much more interesting than the expected interest rate decision.