

FED MONITOR: WATCH YOUR LANGUAGE

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The March [Federal Open Market Committee \(FOMC\)](#) meeting is now in the books, and to no one's surprise, the voting members did not embark on their second [rate increase](#). The obvious question for investors is, where does the [Federal Reserve \(Fed\)](#) go from here? Since the financial crisis and ensuing great recession, the policymakers have been utilizing "forward guidance" as one of the resources in their tool kit. Essentially, this guidance can come in a couple of forms. The first is pretty straightforward: the language used in the policy statement that accompanies each FOMC meeting. The second one comes in the guise of the Summary of Economic Projections (SEP), which is provided four times per year following the March, June, September and December policy meetings. The SEP release also coincides with the Fed Chair's post-meeting press conference. In the SEP, the Fed provides a chart that displays the FOMC's participants' projections of where they see the [Federal Funds Rate](#) for the current calendar year, the subsequent two years and the "longer run." The midpoint target is known throughout the markets as the "[blue dots](#)" and can receive a great deal of attention. Is one of these forms of communication more prescient than the other? In terms of bond market reaction, both can elicit a visible response, but in terms of pure "guidance" from the policymakers, history seems to be more on the side of the policy statement's language. Remember, the blue dots are just FOMC members' estimates at a given point in time, and they are subject to change (as we saw at the March meeting). Meanwhile, the voting members use the language aspect to detail what factors are affecting their decision-making process, and they use it as a signal for a future course of action. Following the recently concluded convocation, both of these forms of forward guidance were deemed to be tilting to the [dovish](#) side, at least according to the [U.S. Treasury](#) market's expectations. In terms of the blue dots, the participants now see only two rate hikes in 2016, as opposed to the four that were projected at the December 2015 meeting. The policy statement acknowledged moderate U.S. economic growth since the Fed last met in January, despite the slowing in global economies and the tightening in financial conditions, and also mentioned that "[inflation](#) picked up in recent months," but still resides below the 2% target. However, more important to the FOMC's outlook is its continued emphasis that "global economic and financial developments continue to pose risks." This is the Fed's way of saying that it is going to be very cautious and deliberate regarding any potential future rate hikes. **Conclusion** While Fed Chair Janet Yellen tried to convey that the April FOMC gathering should be considered a "live" meeting (meaning a rate hike could occur), in reality the probability of such an occurrence seems rather remote. Given the markets' current expectations, the Fed would be unlikely to consider such a move without first providing some forward guidance, something that has been sorely lacking up to this point. It should be noted that even though the results of the March meeting were a bit dovish, the Fed is still keeping its rate hike options open. If financial conditions were to continue to ease from their tightened setting earlier in the year, the Fed could look toward its June meeting for a possible second hike. But once again, we feel the policymakers would prepare the markets for such a possibility and would not raise rates unexpectedly.

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DEFINITIONS

Federal Open Market Committee (FOMC): The branch of the Federal Reserve Board that determines the direction of monetary policy.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Federal Funds Rate: The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Blue dots: the midpoint target range/level of the FOMC participants’ projections for the future Federal Funds Rate.

Dovish: Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

Treasury: Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Inflation: Characterized by rising price levels.