First Trust
ECONOMIC RESEARCH REPORT
Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Economist*
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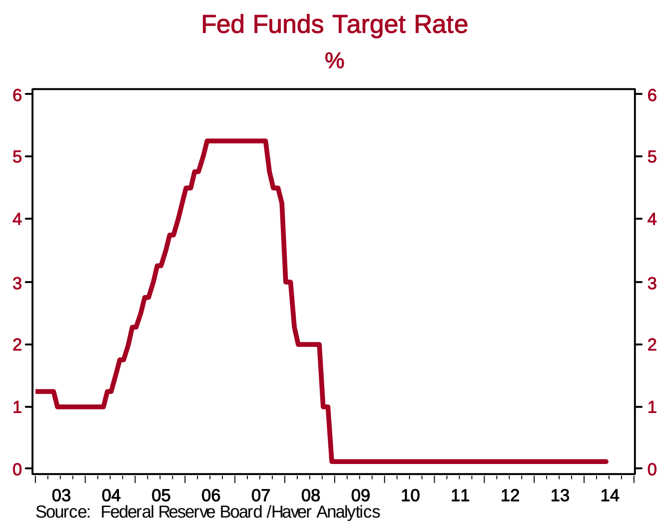
Flock of Doves

If the Fed had made any major news today, it would have been by accident.

Only a few takeaways from today's meeting.

First, this month's Federal Reserve policy statement was almost a carbon copy of the last one (from April). As the world expected, the Fed will keep tapering, cutting another $10 billion from its monthly purchases. The Fed will buy $35 billion in bonds during July, and it looks like the Fed will be done with quantitative easing in late October. The statement included a more positive view of business investment.



Second – the economic outlook. The Fed recognized the weakness in the first quarter and attributed it to weather ("transitory factors," is what Chair Janet Yellen said in the press conference). Outside the first quarter, the Fed's real GDP growth outlook remains essentially unchanged. Its forecast for the unemployment rate is slightly lower but, we think, still too high. The Fed has the jobless rate finishing the year at about 6%; we think it's likely to get below that level.

Third, the Fed made some subtle, but important changes to its interest rate projection. Back in March, the consensus of Fed members said the long-term neutral level of the federal funds rate was 4%; that's now down to 3.75%. But, in the short-term, Fed members raised their forecast for the federal funds rate at the end of 2015 from 1% to a range of 1 - 1.25%. The median forecast for the end of 2016 went to 2.5% from a prior 2.25%. In other words, the Fed hinted at lifting rates a little faster than it had previously indicated, but holding them lower over the long-run. If there was any reason for the market to cheer today, it was this less aggressive longer-term posture.

This all follows our expectations that the Fed will accept higher inflation in the longer-run than its current 2% target suggests. Fed policy is easy, the Fed is making a commitment to keep its balance sheet larger for longer, and it sees no real urgency to raise rates. All of this will create a boost for markets and the economy over the next 12-24 months. Inflation, growth and stock prices will move higher than the consensus expects. And we still think the bond market does not appreciate the danger it faces. While it may not appear like it today, the Fed is falling behind the curve.

Brian S. Wesbury, *Chief Economist*
Robert Stein, *Dep. Chief Economist*

Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in April indicates that growth in economic activity has rebounded in recent months. Labor market indicators generally showed further improvement. The unemployment rate, though lower, remains elevated. Household spending appears to be rising moderately and business fixed investment resumed its advance, while the recovery in the housing sector remained slow. Fiscal policy is restraining economic growth, although the extent of restraint is diminishing. Inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic activity will expand at a moderate pace and labor market conditions will continue to improve gradually, moving toward those the Committee judges consistent with its dual mandate. The Committee sees the risks to the outlook for the economy and the labor market as nearly balanced. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, and it is monitoring inflation developments carefully for evidence that inflation will move back toward its objective over the medium term.

The Committee currently judges that there is sufficient underlying strength in the broader economy to support ongoing improvement in labor market conditions. In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions since the inception of the current asset purchase program, the Committee decided to make a further measured reduction in the pace of its asset purchases. Beginning in July, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $15 billion per month rather than $20 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $20 billion per month rather than $25 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. The Committee's sizable and still-increasing holdings of longer-term securities should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.

The Committee will closely monitor incoming information on economic and financial developments in coming months and will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. If incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings. However, asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly accommodative stance of monetary policy remains appropriate. In determining how long to maintain the current 0 to 1/4 percent target range for the federal funds rate, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. The Committee continues to anticipate, based on its assessment of these factors, that it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored.

When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Stanley Fischer; Richard W. Fisher; Narayana Kocherlakota; Loretta J. Mester; Charles I. Plosser; Jerome H. Powell; and Daniel K. Tarullo.

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