FOR INVESTMENT PROFESSIONALS ONLY. NOT FOR FURTHER DISTRIBUTION.

T.RowePrice®
INVEST WITH CONFIDENCE

PRICE POINT
December 2015

Timely intelligence and analysis for our clients.



Alan Levenson
Chief U.S. Economist

Economies and Markets

FOMC RAISES RATES BUT INDICATES FURTHER HIKES WILL BE GRADUAL

EXECUTIVE SUMMARY

As widely expected, the Federal Reserve's Federal Open Market Committee (FOMC) announced a quarter-point increase in the federal funds target rate on December 16, 2015—the first hike in nearly a decade and a break with a seven-year pattern of near-zero short-term interest rates. In its post-meeting statement, the FOMC noted that it saw economic risks as balanced and removed reference to global economic and financial developments. The FOMC also highlighted the importance that policymakers will place on achieving higher inflation, and noted that further increases are likely to be gradual.

As we and many other observers expected, the FOMC announced on December 16, 2015, that it was raising its target range for the federal funds rate by 25 basis points (0.25%), from a range of 0.00%–0.25% to a range of 0.25%–0.50%. This was the first increase in the federal funds target rate since June 2006 and the first time the rate has been lifted above the zero bound since December 2008.

In concert with raising its federal funds target rate, the FOMC also announced that it was increasing the interest rate on excess reserves to 0.50%, to establish a ceiling on its target range, while raising the rate on overnight reverse repurchase agreements to 0.25%, which establishes a floor.

HIGHLIGHTS OF THE POLICY STATEMENT:

- **Rate guidance is no surprise—further hikes will be "gradual"** (In my view, promising to be "cautious" would have provided investors better guidance): "The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data."

- **The Committee's Summary of Economic Projections remains virtually unchanged.** The median 2016 growth forecast was revised up a tick, while the inflation forecast was revised down a tick. Median 2016–2018 unemployment rate forecasts ticked down to 4.7%. I believe that the unemployment rate will be below 4.7% at the end of next year.

FOMC Summary of Economic Projections

(Median of participants' forecasts)

December 16, 2015

	2015	2016	2017	2018	Longer Run
Real GDP	2.1	2.4	2.2	2.0	2.0
September Projection	2.1	2.3	2.2	2.0	2.0
Unemployment Rate	5.0	4.7	4.7	4.7	4.9
September Projection	5.0	4.8	4.8	4.8	4.9
PCE Inflation	0.4	1.6	1.9	2.0	2.0
September Projection	0.4	1.7	1.9	2.0	2.0
Core PCE Inflation	1.3	1.6	1.9	2.0	
September Projection	1.4	1.7	1.9	2.0	
Fed Fund Rate	0.375	1.375	2.375	3.25	3.5
September Projection	0.375	1.375	2.625	3.375	3.5

Real GDP and inflation measures are Q4/Q4; unemployment rate is Q4 average; fed funds rate is year-end.

Source: Federal Reserve.

- **Policymakers' interest rate forecasts were more tightly grouped in 2016** but more widely dispersed in 2018; median forecasts were little changed. I see the risk as skewed toward less than the median forecast of 100 basis points (1.00%) of rate hikes next year.

THREE THINGS TO NOTE BEYOND THE HEADLINES:

- **The Committee now sees "risks to the outlook for both economic activity and the labor market as balanced."** In its October 28 statement, the Committee saw risks as "nearly balanced" and noted that it was "monitoring global economic and financial developments."

- **The Committee made explicit notice of the importance of actual progress toward 2% inflation**—a nod to the contingent of policymakers who argued in recent months for deferring any action until inflation begins to rise. "In light of the current shortfall of inflation from 2%," the statement noted, "the Committee will carefully monitor actual and expected progress toward its inflation goal."

- **Policymakers also made a stronger statement about the Fed's plans for portfolio reinvestment.** The Committee anticipates reinvesting principal payments "until normalization of the level of the federal funds rate is well underway." The September 2014 statement on "Policy Normalization Principles and Plans" was weaker: "The Committee expects to cease or commence phasing out reinvestments after it begins increasing the target range for the federal funds rate."

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

Important Information

This material, including any statements, information, data and content contained within it and any materials, information, images, links, graphics or recording provided in conjunction with this material are being furnished by T. Rowe Price for general informational purposes only. The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price. The material does not constitute a distribution, an offer, an invitation, recommendation or solicitation to sell or buy any securities in any jurisdiction. The material has not been reviewed by any regulatory authority in any jurisdiction. The material does not constitute advice of any nature and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. Past performance is not a reliable indicator of future performance. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The views contained herein are as of December 2015 and may have changed since that time. Unless indicated otherwise the source of all market data is T. Rowe Price.

Australia - Issued in Australia by T. Rowe Price International Ltd (ABN 84 104 852 191), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. T. Rowe Price International Ltd is exempt from the requirement to hold an Australian financial services licence in respect of the financial services it provides in Australia. T. Rowe Price International Ltd is authorised and regulated by the UK Financial Conduct Authority under UK laws, which differ from Australian laws. For Wholesale Clients only.

Canada - Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services. T. Rowe Price (Canada), Inc. is not registered to provide investment management business in all Canadian provinces. The investment management services provided by T. Rowe Price (Canada), Inc. are only available for use by Accredited Investors as defined under National Instrument 45-106 in those provinces where it is able to provide such services.

DIFC - Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA - Issued in the European Economic Area by T. Rowe Price International Limited, 60 Queen Victoria Street, London EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

Hong Kong - Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Japan - Issued in Japan by T. Rowe Price International Ltd, Tokyo Branch (KLFB Registration No. 445 (Financial Instruments Service Provider), JIAA Membership No. 011-01162), located at GranTokyo South Tower 7F, 9-2, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-6607. This material is intended for use by Professional Investors only and may not be disseminated without the prior approval of T. Rowe Price International Ltd, Tokyo Branch.

Singapore - Issued in Singapore by T. Rowe Price Singapore Private Limited, No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Limited is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

Switzerland - Issued in Switzerland by T. Rowe Price (Switzerland) GmbH ("TRPSWISS"), Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

USA - Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

T. ROWE PRICE, INVEST WITH CONFIDENCE and the Bighorn Sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc. in the United States, European Union, and other countries. This material is intended for use only in select countries.