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FOMC Voters to Tilt More Dovish in 2017

Changes in store for the composition of the voting members of the FOMC suggest that the balance of policy preferences among voting members will shift more to the dovish side in 2017. Presidents Bullard, George, Mester, and Rosengren will move from voting to non-voting status, to be replaced by Presidents Evans, Harker, Kaplan, and Kashkari. On balance, the latter four are more dovish than the first four. In addition, there could be other important changes within the FOMC in the near future that could influence votes on monetary policy: two open positions on the Board of Governors could be filled early in the next presidential term, and there may be other changes as well. Our forecast for a gradual pace of rate hikes is consistent with the more dovish tilt among voting members on the FOMC next year, as we believe that continued strengthening in labor markets and a gradual rise of inflation toward the 2% objective will encourage most members to favor a gradual removal of accommodation through rate hikes.

In this report we also describe our index of FOMC voters' policy preferences, which summarizes the hawk-dove balance among FOMC voters in a single index, taking into account weights that reflect the relative importances of different groups within the FOMC. Voting members on the FOMC are scored on a scale of 1 to 9, with 1 being the most dovish, 5 corresponding to centrist, and 9 being the most hawkish. The same scale is used for the FOMC voting index. Our FOMC voting index currently stands at a mildly dovish reading of 4.2. Changes in the voting status of regional Presidents on the FOMC will lower the index to a more dovish reading of 3.8% in 2017.

With the important caveat that judgements about the relative dovishness or hawkishness of individual members can change because of new information on their views or new economic circumstances, we present our interpretation of the Committee's policy preferences in the chart nearby, and discuss them in the next few sections. As shown in the chart, we rank members on a nine-step scale, with dovish members to the left (1) and hawkish members to the right (9).

The Chair, Janet Yellen

We view the Chair as being to the dovish side of center, based on her willingness to promote further declines in labor-market slack and a wider distribution of economic gains. The Chair is careful to note that the intent to proceed cautiously with respect to the removal of accommodation is influenced by the softness of inflation relative to the Fed's 2% target and some indications from consumer surveys and market-based measures of inflation compensation that inflation expectations have softened in recent years. However, we believe that promoting further strengthening in labor markets is, for her and during this period, a higher priority. Left implicit is the view that, were inflation to rise to or above the 2% target, the Chair would favor a faster pace of rate hikes and exhibit less willingness to promote further declines in slack. This interpretation suggests that the Chair leans to the dovish side, but in a conditional fashion. On a scale of 1 to 9, with 1 being most dovish, we rate her a 3.5, splitting the difference between a dove and being mildly dovish.

FOMC: Hawks and Doves

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<tr><th>Permanent voters</th><th></th><th></th><th></th><th></th><th></th><th></th><th></th><th></th><th></th></tr>
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<tr><td>Governors</td><td>Brainard</td><td>Tarullo</td><td></td><td>Powell</td><td>Fischer</td><td></td><td></td><td></td><td></td></tr>
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President Dudley of New York

On balance, President Dudley of the New York Federal Reserve Bank has expressed views that are broadly centrist, with specific elements that can be viewed as either moderately dovish or moderately hawkish. For example, he has affirmed that he expects the Fed to raise the funds rate before the end of 2016 and favors resuming the process of removing accommodation. He has expressed a narrow band of tolerance around the inflation target, preferring inflation to be neither much below nor much above 2% on a sustained basis. However, he believes that a little slack still exists in labor markets. He does not put much weight on market-based measures of inflation expectations as a signal that inflation expectations may be softening to below 2%, as he views them as influenced by changes in liquidity and term premia. Given his expressed view that he has a very low tolerance for overshooting the inflation objective and his view that a "little" slack remains, we judge him to be a centrist. This is reinforced by our interpretation of his comments suggesting skepticism that the long-run real neutral funds rate will rise appreciably over time. Should inflation show indications of rising above 2%, we would expect President Dudley's to adopt a more hawkish stance.

Other Governors

Continuing with the Governors, communication from the Vice Chair, Stanley Fischer, suggests a more hawkish tilt than the Chair. Fischer views labor markets as very close to full employment and inflation as close to target. Similar to President Dudley, he puts less weight on market-based measures of inflation compensation as an indication that inflation expectations may become un-anchored to the downside. He has also expressed a traditional concern that waiting too long to remove accommodation could result in a more abrupt increase in interest rates later. We expect Fischer to be mindful of the distance between himself and the Chair in public, and we do not expect him to dissent in formal FOMC votes. For these reasons, we rate him as a "5" on the dove-hawk scale, to the hawkish side of the Chair.

In contrast, Governor Brainard has expressed very dovish views, emphasizing downside risks to forecasts for growth and inflation, belief that significant slack remains in labor markets, concern that inflation might not rise to target without further accommodation from monetary policy, and sensitivity to the global impacts of Fed policy decisions.[1] Furthermore, she has been a leading advocate of the "policy asymmetry" view that the Fed's conventional monetary policy tools are less powerful when near the lower bound on interest rates, so policy should remain more accommodative than otherwise to ensure that the economy will withstand future interest-rate increases with little risk of weakening. We rate Governor Brainard very dovish, with a value of "1" on the dove-hawk scale.

Governor Tarullo, like Governor Brainard, wants to see more signs that inflation will rise to the 2% target before raising interest rates. He subscribes to the policy asymmetry argument. He also believes that the FOMC must necessarily "normalize" interest rates and that the FOMC has the tools to respond effectively in the event that the economy overheats. Governor Tarullo has expressed views that are firmly dovish, so we score him as a "2" on the dove-hawk scale.

Governor Powell appears to be somewhat dovish, but less so than some other Governors. As with other doves, he has expressed concern about low readings on market-based measures of inflation expectations, wants to see more evidence that inflation is rising to 2%, and believes that some slack still remains in labor markets. Nevertheless, he views inflation expectations as reasonably well anchored. In August, Governor Powell stated that "we can afford to be patient" while also affirming that "we should be on a program of gradual rate increases," suggesting less dovishness than either Brainard or Tarullo and a little to the hawkish side of the Chair. For the time being, we score him as a "4" on the dove-hawk scale, but would not be surprised to see him move to the center in the future.

Other Rotating Voters in 2016

Within the FOMC, the final 4 voting positions are filled on an annual rotating basis from among the remaining 11 regional Federal Reserve Bank Presidents. In 2016, those voting positions are held by President Bullard (St Louis), President George (Kansas City), President Mester (Cleveland), and President Rosengren (Boston).

Consistent with his regime-centric approach, President Bullard expects that just one quarter-point rate hike by the FOMC will be sufficient for the foreseeable future, given that inflation and labor markets are close to the Fed's objectives and that real returns on government debt remain very low.[2] Effectively this makes him among the most dovish members on the Committee, so we score him as a "1" on the dove-hawk scale. However, in his regime-oriented approach to monetary policy, President Bullard's views on interest-rate policy could evolve as circumstances change, possibly resulting in less dovish or even hawkish views in the future.

Presidents Rosengren, Mester, and George are each relatively hawkish. President George has dissented several times in 2016 in favor a rate hike, reflecting her view that the economy is essentially at full employment and inflation is close to target. She is concerned that without raising rates now, the FOMC will fall behind the curve and will raise uncomfortably the risk of overshooting its objectives, including its objective for inflation. Back in May, President George stated plainly that "the current level [of the funds rate] is too low for today's economic conditions." President Mester dissented in favor of a quarter-point rate hike at both the September and November meetings, while expressing views that are broadly similar to those of President George. President Rosengren, who in the past had been viewed as more dovish, dissented in favor of a rate hike at the September meeting, before then joining the majority to remain on hold at the November meeting out of concern for election-related uncertainty (while also signaling that he expects to raise rates in December). He has expressed concern about frothiness in commercial real estate and concern that if the Fed were not to resume rate increases now, this could raise the risk of overheating and result in a more abrupt increase in interest rates later. On the dove-hawk scale, we score President George as the most hawkish (9), President Mester as a strong hawk (8), and President Rosengren as a hawk (7).

[1] In contrast, Stanley Fischer stated unequivocally in July that the US economy is the Fed's priority.

[2] Please see MA's *Macro Focus*, "Bullard's Regime-Dependent Policy Framework," August 8, 2016.

On average, the four rotating voting members in 2016 — Bullard, George, Mester, and Rosengren — are hawkish, with an average score of more than 6.

Other Members (Not Voting in 2016)

The remaining 7 regional presidents do not vote in 2016, but they do participate in the FOMC's deliberations, and four of those will become voters in 2017 — Harker (Philadelphia), Evans (Chicago), Kaplan (Dallas), and Kashkari (Minneapolis). The final 3 — Lacker (Richmond), Williams (San Francisco), and the President of the Atlanta Fed — along with President Mester, will constitute the four rotating voting members in 2018.[3]

President Lacker is one of the most consistent and firmly hawkish members on the FOMC, having repeatedly expressed his view that the economy could threaten to overheat and that the funds rate target should already have been raised a percentage point or so above its current level. We score him as very hawkish (9). President Harker, who became President of the Philadelphia Federal Reserve only a little over a year ago, and who has yet to cast a formal vote on interest-rate policy, has tended to express centrist or mildly hawkish views, so we score him as a (6). President Lockhart has expressed largely centrist views, and is of the opinion that the Fed should resume raising rates. As noted in a previous footnote, his term on the FOMC will end in early 2017.[4] President Kaplan, who, like Harker, joined the FOMC in 2015, has expressed views that are consistent with the central tendency of the Committee, so we score him as a (4). It is possible that as he moves into voting status in 2017, he could seek to carve out a more distinctive and possibly more hawkish position.

President Kashkari of Minneapolis is a self-described dove; we score him as a solid dove (2). President Evans, who, like Kashkari, becomes a voting member in 2017, is also a dove. While he has expressed a willingness to go along with the majority of the Committee on interest-rate decisions, he has been outspoken that more slack remains in labor markets and that inflation expectations threaten to become un-anchored to the downside. These views lead him to prefer a policy of holding back on further rate increases until inflation rises to at least 2% on a sustained basis, and to promote policies that result in an overshoot of the 2% inflation objective to reinforce credibility in the Fed's symmetric inflation objective. We rate President Evans as a solid dove (2).

It is a challenge to characterize President Williams on a one-dimensional, dove-hawk scale. On the one hand, for some time he has expressed views consistent with an earlier or faster increase in interest rates to reduce the risk of overheating and a more abrupt increase in interest rates later, while still providing enough accommodation to achieve the Fed's objectives for inflation and labor markets. He has characterized labor markets as being close to full employment and expressed a desire to see the process of removing accommodation through interest-rate increases to be resumed. On that basis, he could be characterized as a hawk. On the other hand, within the FOMC, he has taken the lead in exploring alternative frameworks for monetary policy, such as nominal GDP targeting or a higher inflation target, which could result in inflation running above 2% either for a period of time, or in the case of a higher inflation target, permanently. Based on his research (with Thomas Laubach and others) pointing to a very low level for the real neutral funds rate, he has suggested that there might not be much accommodation implicit in the current level of the federal funds rate, indicating a possibility that the funds rate may rise by much less than the currently anticipated by most FOMC members. Tentatively, we score President Williams as a centrist (5), but are prepared to change that assessment pending future developments.

Index of FOMC Voting Tendencies

With these scores in hand, it is possible to derive an aggregate index of the monetary policy views of the voting members on the FOMC, which reflects their dovishness or hawkishness. Voting weights are scaled so that they sum to one. Recognizing her preeminent role, the Chair is assigned the highest weight (table nearby). Successively smaller weights are assigned to the President of the New York Fed, the Vice Chairman

[3] President Lockhart has announced that he will retire from his position at the Federal Reserve Bank of Atlanta in February 2017. A replacement has not been announced. In what follows, we assume, pending an announcement, that the next President of the Atlanta Federal Reserve Bank will be a centrist.

[4] The Atlanta Federal Reserve Bank does not becoming a voting member on the FOMC until 2018.

	Relative Weights in FOMC Voting Index
Chair, Board of Governors (& Chair of the FOMC)*	0.33
President of New York Fed**	0.19
Vice Chair, Board of Governors	0.14
Other Governors (per member)	0.06
Rotating Voters (regional Presidents, per member)	0.04
Non-voting regional Presidents	0

* The Chair of the Board of Governors serves as the Chair of the FOMC.
** By tradition, the President of the New York Fed serves as Vice Chairman of the FOMC.

of the Federal Reserve, the remaining members on the Board of Governors of the Federal Reserve, and finally, the 4 voting members among the remaining 11 regional Federal Reserve Bank Presidents. Non-voting members (the remaining 7 regional Presidents) receive a weight of zero. We don't intend that these weights be taken too literally or as fixed permanently: in different circumstances or with different personalities, certain members could be either more or less influential than the weights suggest.[5] However, we think they convey the essence of the relative influence on FOMC outcomes, with the greatest weight, unequivocally, possessed by the Chair.

Based on the scores for individual members and these weights, our FOMC voting index registers at a mildly dovish reading of 4.2. Looking ahead to 2017, there will be major changes within the FOMC. The rotating voting members drawn from the regional Presidents will shift from Bullard, George, Mester, and Rosengren, a generally hawkish group, to Evans, Harker, Kaplan, and Kashkari, a generally dovish to centrist group. In fact, the average score just for the four rotating voters is projected to fall sharply from 6.3 in 2016 to 3.5 in 2017. **For the voting members of the FOMC as a whole, the index is projected to decline to a more dovish reading of 3.8 in 2017, then rebound to 4.3 in 2018** when Lacker and Mester become voters, along with Williams and the President of the Atlanta Federal Reserve (to be determined).

The movement in 2017 to a more dovish tilt among voting members on the FOMC is consistent with MA's expectation that the FOMC will continue the process of gradually removing accommodation with additional interest rate hikes in 2017. We expect that as inflation moves closer to the 2% target and labor markets continue to strengthen, most of the doves on the Committee will acquiesce to additional rate increases clearly favored by the centrist and more hawkish members, albeit in a cautious and gradual fashion as long as inflation does not rise above target or the economy show signs of overheating. Nonetheless, dissents in favor of a slower pace of rate hikes from some of the most dovish members are, depending on circumstances, a possibility in 2017.

There could be other significant changes to the FOMC in the near future.[6] As President, Donald Trump will have an opportunity to make appointments next year to fill the two open positions on the Board of Governors. Furthermore, some current Board members might resign before the ends of their terms. President Lockhart of Atlanta will resign in February 2017; his replacement has not been announced. The terms of the Chair and Vice Chair expire in 2018. William Dudley's term as President of the New York Federal Reserve Bank ends in early 2019.

[5] As the number of voting members changes, as when open Governorships are filled, the weights will be adjusted so that they continue to sum to one when applied to all voting members.

[6] For further details, please see MA's *Recently Asked Questions* on the "Federal Reserve Board of Governors and the Next President," October 25, 2016.

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