ECONOMIC INSIGHTS

Robust Economy Keeps Fed on Track for More Rate Hikes

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We see three more rate increases from the U.S. Federal Reserve by June 2019.

As widely expected, the Federal Open Market Committee (FOMC), the policy-making unit of the U.S. Federal Reserve (Fed), raised the benchmark fed funds rate by a quarter-percentage point, to a range of 2%-2.75%, at its meeting on September 26, 2018.

The fed funds rate hike marked the eighth rate increase since December 2015 and the third rate hike this year. "The U.S. economy has been coming in stronger than expected this year," said Fed chairman Jerome Powell at a press conference following the meeting. Powell cited high business and consumer confidence readings, as well as the tax cuts implemented in December 2017.

Notably, the statement released at the end of the meeting differed from the previous statement in one important respect: it removed reference to "accommodative" Fed policy. This likely means rates are getting close to the "neutral" level. The deletion, however, does not imply that the future rate path has changed. Given the continued strength, we believe that increases in December 2018, and March and June of 2019 are still likely, the same rate path as expected before this meeting.

Much depends, of course, on the trajectory of inflation. If inflation remains around 2%, the Fed is likely to pause in mid-2019 and assess how the economy has responded to the rise in rates since late 2015. But in the post-meeting press conference on September 26, Powell took pains to point out that if inflation surprises to the upside in the months ahead, the central bank is poised to "move faster" on rates. With the U.S. labor market running at full steam, and wages undergoing a long-awaited acceleration, policymakers will be watching the employment data carefully for any signs that inflation will alter their plans.

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