

## Four things to watch from the Fed this week

The strength of the domestic economy and rising price pressures will ensure another rate hike on Wednesday, but will emerging market and trade concerns result in a slower path of Fed tightening next year?



Source: Federal Reserve

### Expect the Fed to hike by another 25bp this week

The Federal Reserve's FOMC gathers again this week to set monetary policy and a 25 basis point interest rate rise is the near-universal expectation. Growth is undoubtedly very strong, with high-frequency indicators suggesting activity likely accelerated in 3Q18 after the economy expanded at an already stellar 4.2% annualised rate in 2Q18. At the same time, all of the major inflation measures are at or above the Federal Reserve's 2% target, wages are picking up, the unemployment rate is close to an 18-year low and asset prices continue to rise. All this points to further tightening of policy.

We are also seeing a broadening out of the reasoning for higher interest rates. For example, Boston Fed President Eric Rosengren has repeatedly warned that monetary policy should be tightened from a financial stability perspective. He and others worry that unduly low borrowing costs could be the trigger for excessive risk-taking, which will store up trouble for the US economy in the future.

For that reason, we expect a rate hike this week and another in December. But markets will

be watching closely for hints about the Fed's plans for 2019. Here are four things worth watching at this week's meeting:

## 1 Shrugging off trade tensions

For now, the Federal Reserve does not seem particularly worried about the intensifying trade war. The domestic story is clearly robust and the Fed will no doubt want to see some impact from trade tensions before altering its course – survey evidence that some businesses are reconsidering investment decisions is not going to be enough.

As for the inflation threat, [as we noted last week](#), even in a worst case scenario where all Chinese imports were immediately subject to a 25% tariff and this was passed directly onto consumers, it would only lift headline inflation by around one percentage point. More likely, we see mitigating factors limiting this to 0.4 percentage points.

## 2 America First at the Fed despite EM risks

Strife in emerging markets is also unlikely to deter the Fed. Under former Fed Chairs Alan Greenspan, Ben Bernanke or Janet Yellen things may have been different, but the Jay Powell Fed is much more focused on the domestic story. Earlier this year he brushed aside criticism that the Federal Reserve wasn't thinking enough about the international implications of higher US borrowing costs, saying "the role of US monetary policy is often exaggerated". We agree that there isn't a great deal the Federal Reserve can do to address the fundamental challenges facing many of these emerging market economies, but a strong dollar and higher US borrowing costs certainly won't help their situation.

As such we expect the Federal Reserve to continue describing monetary policy as "accommodative", which will warrant "further gradual increases" in interest rates. The Federal Reserve will also be updating their forecasts, which were last published in June. This could see their GDP prediction nudged a tenth higher, while their so-called "dot diagram" of Fed member views is likely to continue pointing to a December rate rise with a median projection of three more 25 basis point rate increases next year – although with the usual broad spectrum of views within that.

## 3 Trump's reaction?

Donald Trump is unlikely to be particularly happy about this decision, having stated he was "not thrilled" by higher interest rates earlier this year. President Trump believes that the Fed is offsetting "all of this work that we're putting into the economy" and given the proximity to the upcoming mid-term elections, he could voice his irritation again after this week's interest rate rise. Presidential concerns are likely to fall on deaf ears though, given the strength of the US economy right now and the Fed's determination to defend its independence.

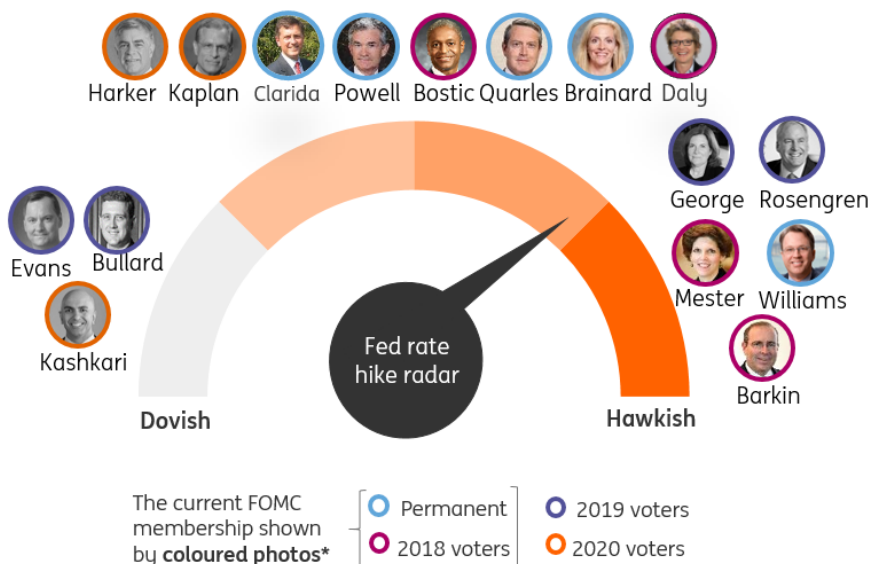
## 4 Fed to slow the pace of hikes in 2019

However, we do see the US economy facing more headwinds as we move into 2019. The massive fiscal stimulus of tax cuts and increased Federal spending early this year won't be repeated and the support from that stimulus will gradually fade. Tighter financial conditions in the form of higher US borrowing costs and the stronger dollar will also act as a brake on growth. Then there is the


gradual drag from trade tensions that will impact supply chains and put up the cost of doing business, while emerging market weakness could start to exert more of a drag on global and US activity. This should help to dampen inflation pressures in the medium term.

That is not to say the US economy runs the risk of a sharp downturn - we still think the economy will expand a very healthy 2.3% next year versus 2.9% this year – but we wouldn't be surprised to see a slower pace of interest rate rises in 2019. After four hikes in 2018, we are looking for a more conservative two rate moves next year, with 1Q19 and 3Q19 our favoured periods.

## **What Fed members are saying**



**Neutral**  
 "The economy is strong. Inflation is near our 2 percent objective, and most people who want a job are finding one. My colleagues and I are carefully monitoring incoming data, and we are setting policy to do what monetary policy can do to support continued growth, a strong labor market, and inflation near 2 percent.."




**Jerome Powell**, Fed Chair

**Hawkish**  
 "These developments raise the prospect that, at some point, the Committee's setting of the federal funds rate will exceed current estimates of the longer-run federal funds rate"



**Lael Brainard**, Board of Governors

**Hawkish**  
 "I don't see an inverted yield curve as being a deciding factor in terms of thinking about where we should go with policy"




**John Williams**, New York Fed

**Neutral**  
 "I will not vote for anything that will knowingly invert the curve and am hopeful that as we move forward I won't be faced with that"



**Raphael Bostic**, Atlanta Fed

**Hawkish**  
 "If things work out well for the economy, and that's what I expect and hope for, then we'll be in a situation where we need to have somewhat restrictive policy over time"



**Eric Rosengren**, Boston Fed

\*Richard Clarida has joined as vice-chair of the Board (permanent voter), and Mary Daly has been appointed as new head of the San Francisco Fed (voting in 2018), though she will not formally take up her position until October 1<sup>st</sup>. Three of the seven positions (permanent voters) on the Board of Governors remain vacant.  
 Source: ING

## Author

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.