

## Federal Reserve: Onwards and upwards

The Fed voted unanimously for another 25 basis point rate rise and while policy is no longer described as “accommodative” the “gradual increases” in the Fed funds rate look set to continue for at least another couple of quarters



Source: Shutterstock

### A tweak in the language...

As almost universally expected the Federal Reserve has decided to raise the Fed funds target rate range another 25 basis points to 2-2.25%. The accompanying statement has dropped the sentence that described the Fed’s monetary stance as “accommodative”, but hasn’t replaced it with any other descriptors. However, the Fed continues to expect that “further gradual increases” in the policy rate will be required for them to achieve their growth, labour market and inflation mandate. There were no other changes to the text with activity and job gains still described as “strong” while inflation remains near target.

### New Forecasts suggest upside risks

The Fed has updated its economic projections though, with an extra “dot” in the form of new Fed Vice Chair Richard Clarida. GDP growth expectations for 4Q18 have been upped to 3.1% from 2.8% in June while the 2019 forecast has been raised a tenth of a percentage point to 2.5%. The

forecast range has been extended to 2021, which is expected to see growth of 1.8%, down from 2% in 2020. This 1.8% figure is in line with the Fed's longer-run growth expectation. These projections are broadly in line with our own forecasts.

Inflation forecasts have barely changed and point to ongoing outcomes close to 2%. Unemployment projections are also broadly unchanged with 3.5% expected to be the low through 2019 and 2020.

As such the Fed continues to predict a central rate of 2.4% for end 2018 – implying one more rate rise this year. While 2019 is pencilled in at 3.1%, implying three rate rises and 2020 is at 3.4%. This appears to be the peak with the new 2021 prediction also 3.4%. However, the Fed has bucked the recent trend of cutting its longer-run projection and actually nudged it up to 3%.

## ING's view

In terms of our view for Fed policy, economic activity is undoubtedly very strong with another 4%+ GDP growth figure looking possible for 3Q18, while 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. These all point to further interest rate rises, with another 25 basis point rate hike looking probable for December – 12 of 16 Fed officials predict it in the "dot diagram".

However, the outlook is more clouded for 2019. A recent Bloomberg survey suggests that analysts are favouring a 25bp rate hike in each of the first three quarters of 2019, identical to the Fed's guidance within today's forecasts. The market, on the other hand, is only really pricing in one hike next year. We are in the middle favouring two – one in 1Q19 and one in 3Q19.

We see the US economy facing more headwinds as we move into 2019. The support from this year's massive fiscal stimulus will gradually fade while 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. The caveat is that if these external tensions ease then we would be willing to raise our forecast to three 25 basis point rate rises in 2019.

## Author

**James Knightley**

Chief International Economist

[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>.