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Article

Federal Reserve preview: Sticking to the script

While no longer described as 'accommodative', monetary policy is far from restrictive. A strong domestic story means the Federal Reserve will continue to signal "gradual" rate hikes ahead, setting us up for a December move and then three more hikes in 2019

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In line with its stance of 'gradual' monetary policy tightening the Federal Reserve has raised interest three times this year at a pace of one 25basis point move per quarter – which works out at a hike every other meeting. Given the Fed raised interest rates at the last meeting in September, this Thursday's FOMC announcement will see a "no change" outcome, but the tone of the accompanying press release will point strongly to a December rate move.

> We continue to predict a rate hike in each of the first three quarters of 2019, but we think that will bring an end to the Fed's policy tightening

After all, the economy is booming. GDP growth is set to hit 3% this year, the fastest rate of expansion for 13 years, while wages are rising at their fastest rate for nine years and the unemployment rate is the lowest it has been for 48 years. At the same time inflation is at or above target on all of the key measures the Fed watches. The Fed may have dropped the line that monetary policy "remains accommodative" at the September FOMC meeting, but the policy is a long way off being regarded as restrictive given these metrics.

> Slower growth outside the US will also act as a brake and with Tuesday's mid-term elections set to return a split Congress - the prospect of additional fiscal support will fade

Moreover, September forecasts from the Fed showed that officials believe that the most likely course of action remains they hike once more this year (at the 19 December 19 meeting) and raise interest rates on three occasions in 2019. This would take the target range for Fed funds up to 3-3.25% with an additional rise in 2020 to 3.25-3.5%. President Trump is not happy, feeling that higher interest rates are diluting the positive economic support from his massive fiscal stimulus, but his protests will fall on deaf ears at the Fed.

We certainly agree with the December rate rise – new economic forecasts will be published and Fed Chair Jerome Powell gives another press conference to explain the rationale.

We also continue to predict a rate hike in each of the first three quarters of 2019. However, we think that will bring an end to the Fed's policy tightening. Trade uncertainty is creating a headwind for activity and as the support from the fiscal stimulus fades, and the lagged effects of higher US interest rates and a stronger dollar are felt increasingly, the US will lose some momentum.

Slower growth outside the US will also act as a brake and with Tuesday's mid-term elections set to return a split Congress - the prospect of additional fiscal support will fade. This will take the pressure off the Fed to continue hikes into 2020.

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