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Federal Reserve reaction: No deviation

The Federal Reserve has left policy unchanged. The accompanying statement continues to provide an upbeat assessment, necessitating ongoing "gradual" interest rate hikes

Source: Shutterstock

1.75-2% Fed funds target range

The Federal Reserve has left monetary policy unchanged and the accompanying statement is little changed versus June. The main tweak is that they now state economic activity is expanding at a "strong" rate, rather than "solid" as they described the situation in June. It also sounds as though they acknowledge a pick-up in inflation, stating that inflation will "remain near" 2% rather than "have moved close to" 2% as stated in June. These are marginal changes with the main point being that they are sticking to the assessment that "further gradual increases" in interest rates are anticipated by the FOMC.

Last Friday's GDP report really underlined the positives within the US economy. Businesses and households are reaping the benefits of massive tax cuts while the jobs market goes from strength to strength. While we are likely to see a bit of a slowdown in 2H18 reflecting tighter monetary conditions and some nervousness over trade protectionism we still expect to see 3% GDP growth for 2018 as a whole.

At the same time inflation is approaching 3% and there is growing evidence that wage growth is showing signs of life. Consequently, we see some risk to the market's benign reading of inflation prospects in the months ahead. Trade policy remains a threat, but for now the positives significantly outweigh the negatives, hence the Fed's decision to stick to the "gradual" rate hike path. As such we look for rate hikes in September and 4Q18 – probably December – with two more coming in 2019. The risks, in our view, remain skewed to the upside.

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