

One down, three more to come?

The Fed raises rates by 25bp and indicates more hikes ahead



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As expected, FOMC policymakers raised rates by 25bp to a target band of 1.5-1.75%. With dovish members Kashkari and Evans (who opposed the last hike in December) dropping to non-voting status in 2018, there were no dissenting votes.

The statement released alongside the rates decision suggests the committee's assessment of the economic outlook remains upbeat. There are few changes from the January statement, though reflecting the two strong jobs reports since their last meeting, the FOMC now notes that "job gains have been strong in recent months, and the unemployment rate has stayed low".

Growth forecasts were revised upwards again, to 2.7% in 2018 and 2.4% in 2029 (from 2.5% and 2.1% respectively), likely on account of stronger near-term momentum and incorporating the further fiscal boost from the additional spending package agreed by Congress in February.

The projection for inflation also strengthened slightly, to 2.1% in 2020 on both the headline and core inflation measures (from 2.0% previously). This is a small change but significant because it means the Fed is now projecting inflation a touch above target, strengthening the case for more rate hikes.

2.1%

Fed projection for core inflation in 2020

Above target

Some FOMC members have also shifted their projections of future interest rates upwards, indicating they expect rates rise somewhat faster and further than previously anticipated. The median dot now in 2018 still indicates two further hikes this year, but the projection now indicates three hikes in 2019 (up from two) and two full hikes in 2020. The median expected long-run rate has shifted up from 2.8% to 2.9%.

The dispersion of the dots has also increased, with one committee member now indicating a preference for rates near 4% in 2019 and 5% in 2020. That means we now have a hawkish counterpart to Kashkari's persistently dovish stance. And given at least two of the lower dots belong to non-voters (Kashkari and Evans), the committee is likely to tilt a bit more towards the hawkish camp in 2018 than indicated by the dots alone.

To us, all this indicates that more rate hikes are likely on the way. The US economy continues to grow strongly and fiscal stimulus will boost the expansion further. With inflation set to pick up towards the summer, we think three more rate increases in 2018 is the base case. Should momentum remain strong into 2019, there is a chance that we could see another three hikes in 2019.

That said, we see two key risks that could prompt the FOMC to reassess the outlook, which Chairman Powell is likely to be asked about in the upcoming press conference. The first is renewed market turmoil: while the Fed appears fairly sanguine about the VIX episode in early February, a more severe and sustained bout of volatility that led to a tightening of financial conditions could give the Fed reason to pause. The other risk is an escalation of tensions around the US' aggressive tariff policy into a full-blown trade war, which could cause the global economy to slow down pre-maturely.