The Fed: Support for a December rate hike

The US Federal Reserve leaves monetary policy unchanged and the focus turns to who'll be its next Chair

Source: Federal Reserve

As widely expected the Federal Reserve has left monetary policy unchanged. There is no news conference or forecast update from the Fed for this meeting, but the press release offers support for the December rate rise that most economists, ourselves included, are predicting. Having described the economy as expanding “moderately” in September they are now offering a more upbeat assessment, saying "economic activity has been rising at a solid rate despite hurricane-related disruptions".

In terms of inflation, there is no change in their view that it will return to the Fed's 2% target "over the medium term". Consequently, we get a reiteration that monetary policy will be “gradually” tightened and that the economic risks are "roughly balanced".

Given the strong economy and jobs market, inflation pressures gradually building and Fed officials broadening out the reasons behind hiking – such as financial conditions, asset valuations and financial stability issues – we are still sticking to our view of a December rate hike. This is 80% priced in by financial markets with the main risk coming from the potential for an economically damaging government shutdown in the absence of an agreement to raise the debt ceiling.

As for the 2018 outlook for policy, it really depends on who President Trump announces on Thursday who'll be the next Fed chair. Under the leadership of incumbent, Janet Yellen or the market favourite, Jerome Powell, we expect two more 25bp Fed rate hikes in 2018 rather than the three the Fed have currently pencilled in. This is mainly down to the Fed's balance sheet reduction strategy doing some of the heavy lifting to tighten financial conditions, reducing the need for hikes at the short-end of the curve.

However, should it by John Taylor or Kevin Warsh, who appear to be backing a more mechanistic (and hawkish) approach to implementing Federal Reserve policy then we would likely put in a third hike and possibly even a fourth. Whoever Trump chooses we think the market is being far too conservative in barely pricing in one hike for next year.

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