

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 be 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.

Author

James Knightley

Chief International Economist, US

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>.