First Trust
ECONOMIC RESEARCH REPORT
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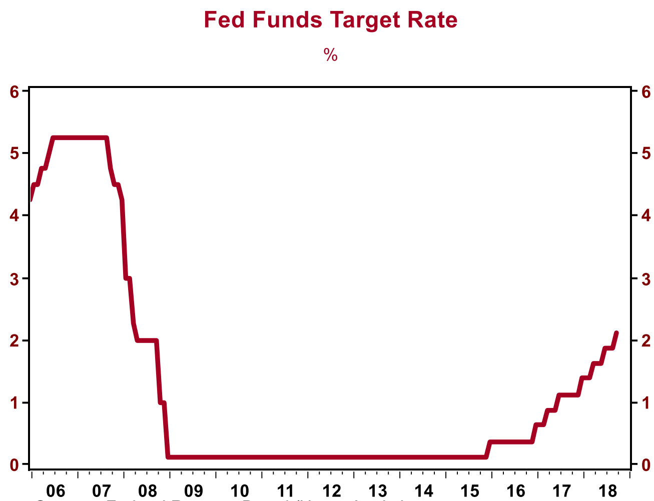
Full Steam Ahead

As expected, the Federal Reserve raised rates by 25 basis points today. And at this point, the outlook for the remainder of 2018 looks largely determined, with both 75% of Fed officials and the markets pricing in one more rate hike in December to make it four for the year. What remains to be seen – and the focus for many with today's release – is how policy will develop in 2019 and beyond.



Source: Federal Reserve Board /Haver Analytics

The only substantive change in today's statement was the removal of a sentence noting the stance of monetary as "accommodative" and supportive of both the labor market and the Fed's 2% inflation target. The doves will focus on this deletion as a sign the Fed thinks monetary policy is already neutral, limiting the outlook for hikes in the year ahead. We disagree. Chair Jerome Powell made a point in his press conference that the language removal doesn't change their outlook for continued gradual rate hikes (and that even including today's hike the federal funds rate stands below the long run forecast level of all sixteen committee participants). The change is little more than an acknowledgement that both inflation and employment have reached or surpassed target levels, and further "support" isn't necessary.

Updates to the projection materials (the "dot plots") also reinforce the outlook for higher rates through 2019. As noted above, FOMC members believe that a fourth hike is appropriate before year-end, while the outlook for 2019 has a median forecast of three hikes (and the financial markets have odds on just two hikes next year). This is little changed from the June forecasts, despite upward revisions to GDP forecasts for both this year and next. Worth noting is that the Fed has raised GDP growth forecasts with each of the last four projection releases.

While we agree with the Fed's forecast of 3%+ real GDP growth in 2018, we also expect growth next year to be 3%+ as well, while the Fed is forecasting real growth of 2.5%. Paired with continued strength in employment and inflation at or above 2%, we continue to expect four 25 basis point rate hikes in 2019, just like we expect this year. And with nominal GDP growth - real growth plus inflation - above 4.5% at an annual rate over the past two years, monetary policy will still not be tight for years to come.

In short, the path towards higher rates remains on track at a steady pace. Thanks to policy changes ranging from tax cuts to regulatory relief and attractive depreciation schedules, the economy is humming along and the "data dependent" Fed has received overwhelming data to prove it.

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Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in August indicates that the labor market has continued to strengthen and that economic activity has been rising at a strong rate. Job gains have been strong, on average, in recent months, and the unemployment rate has stayed low. Household spending and business fixed investment have grown strongly. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2 percent. Indicators of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. Risks to the economic outlook appear roughly balanced.

In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to 2 to 2-1/4 percent.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent *inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.*

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chairman; John C. Williams, Vice Chairman; Thomas I. Barkin; Raphael W. Bostic; Lael Brainard; Richard H. Clarida; Esther L. George; Loretta J. Mester; and Randal K. Quarles.