Central Banks

FOMC Stands by its stars

Boyd Nash-Stacey and Nathaniel Karp

As we expected, the FOMC raised its benchmark rate for the fourth time this year to 2.25-2.50%. The assessment of growth, labor markets and inflation remained effectively unchanged. On the policy outlook, the FOMC reaffirmed that further rate increases are consistent with the ongoing expansion. However, the paragraph was adjusted to signal more uncertainty and a shallower path. This is consistent with a federal funds rate that has finally reached the lower end of the neutral range. It also implies that future actions will be highly dependent on incoming data. In fact, the longer run projection for the Fed funds rate edged down to 2.8% from 3% in September. Although the FOMC views the risks to the outlook as balanced, the statement added that the Committee will "monitor global economic and financial developments and assess their implications for the economic outlook."

In the press conference, Chairman Powell defended the Committee's decision to raise rates and its bias towards further increases despite inflation remaining below the Fed's 2% target for seven consecutive years. Powell also stressed that the target remains symmetric. In addition, Powell dismissed the idea that the unwinding of the balance sheet is the primary cause of financial volatility. The Fed Chairman also hinted that the CCyB is unlikely to be activated early next year when the Fed reviews financial vulnerabilities.

Markets participants were surprised by how the Fed stuck to its guns and kept its strategy unchanged. The S&P500 declined 1.5% while the 10Y Treasury yield dropped 6bp to 2.76%. In contrast, the USD remained relatively stable against most major currencies.

In line with our scenario, the Fed confirmed that, based on current and expected economic conditions, additional rate increases are warranted. Furthermore, although the ongoing asset price correction could influence growth in the short-term, it will ultimately reduce systemic risk and the magnitude of the adjustment.

Chart 1. FOMC Median Projections (SEP), %

	2018	2019	2020	2021	Longer run
GDP	3.0	2.3	2.0	1.8	1.9
Sept. 2018	3.1	2.5	2.0	1.8	1.8
Dec. 2017	2.5	2.1	2.0		1.8
Unemployment Rate	3.7	3.5	3.6	3.8	4.4
Sept. 2018	3.7	3.5	3.5	3.7	4.5
Dec. 2017	3.9	3.9	4.0		4.6
PCE Inflation	1.9	1.9	2.1	2.1	2.0
Sept. 2018	2.1	2.0	2.1	2.1	2.0
Dec. 2017	1.9	2.0	2.0		2.0
Fed funds	2.4	2.9	3.1	3.1	2.8
Sept. 2018	2.4	3.1	3.4	3.4	3.0
Dec. 2017	2.1	2.7	2.9		2.8

GDP & PCE are YoY % change for fourth quarter; UR is the average for the fourth quarter; the federal funds rate is the midpoint at the end of the year

Chart 2. Market Rate Expectations, Implied Probability