Fed remains intent on hiking rates

The November meeting of the US Federal Reserve back at the start of the month saw the Central Bank maintain the target range for the fed funds rate at 1-1.25%. The decision to leave rates unchanged was unanimous.

With no press conference or updated staff projections, the main focus was on the meeting statement. The text contained only modest changes compared to the September version.

The Fed upgraded its characterisation of the economy's performance. It stated that "economic activity has been rising at a solid rate despite hurricane-related disruptions", a change from its previous description of activity increasing "moderately". The US economy is expected to grow by more than 2.1% again this year.

In its description of the labour market, it remained of the view that the data indicate that it continues to strengthen. Indeed, official data released since the meeting have collaborated the Fed's view on the jobs front. Payroll figures for October registered a strong 261,000 gain in the month.

Meanwhile, in its assessment of the inflationary backdrop, the Fed noted that inflation for items other than food and energy "remained soft". Indeed, the Fed continues to anticipate that inflation will remain somewhat below its 2% target in the near-term, before starting to stabilise closer to its objective over the medium-term.

In terms of the Fed's interest rate guidance, the most recent set of projections were released at its September policy meeting. The Fed is still indicating that it will hike one more time this year, bringing rates to 1.375%. The median projection for end-2018 was unchanged at 2.125%, consistent with three 25bps hikes next year. It did slightly revise lower its end-2019 projection, expecting rates to finish the year at around 2.75%.

The market has started to price in more rates hikes over the past two months. However, based on futures contracts, the market is still expecting a less aggressive path of rate hikes than the Fed is guiding over the next 2-3 years.

While the December rate hike is fully priced in, current pricing suggests that the market is looking for rates to rise to around 2% by end-2019 compared to the aforementioned Fed projection of 2.75%.

Overall, it looks like a December rate hike from the Fed is very much on the cards. Looking ahead to next year and beyond, the Fed will be under a new Chair, with Jerome Powell nominated to take the helm. However, his policy outlook is very similar to the current Chair, Janet Yellen.

Therefore, the extent of rate hikes will continue to be determined in the main by macroeconomic and financial market conditions. If the incoming macro data continue to point to solid growth and financial market conditions remain benign, it will increase the chances of the Fed following through on its indicated rate hike trajectory.

The Fed may also have more details over the coming months on President Trump's fiscal stimulus programme, which it can factor into its future policy decisions. Tax cuts should boost US growth and leave the Fed more inclined to hike interest rates.

Of course, inflation is a key consideration for the Fed. If it remains subdued, then the Fed may not tighten policy as much as it has indicated. So, the US Central Bank has much to ponder as it moves rates back to more normal levels in the next couple of years.

John Fahey

Senior Economist

AIB

* *

AIB Customer Treasury Services
DUBLIN / CORK
fxcentre.aib.ie

Customer Treasury Services NI
BELFAST
firsttrustbank.co.uk/fxcentre

Customer Treasury Services GB
LONDON
aibgb.co.uk/fxcentre

Customer Treasury Services US
NEW YORK
fxcentre.aib.ie