Economic Flash!

June 13, 2018

Royce Mendes (416) 594-7354
Katherine Judge (416) 956-6527

US Fed Outlook: Faster Pace, Same Destination

- In what was a well-telegraphed move, FOMC members voted unanimously to raise the federal funds target rate by 25bps. With the move anticipated, investors' attention quickly turned to the dot-plot forecasts which now indicate central bankers see four rate hikes in 2018, up from three in the previous set of numbers.

- To justify the acceleration in the pace of rate increases, growth and core inflation forecasts were also upgraded for 2018, and the unemployment rate is now seen as falling even further. But, while the Fed expects a slightly faster pace to rate hikes, the eventual destination remains the same. Indeed, the projection for rates in 2020 and the longer-term forecast didn't budge from 3.4% and 2.9%, respectively.

- Given the revised numbers, it now appears that FOMC members see the economy chewing through whatever slack remains a little faster given the boost from fiscal stimulus, but that additional government spending and tax cuts haven't done much to alter structural trends keeping a lid on the fed funds rate longer-term.

- We're not ready to pencil in a fourth 2018 rate hike just yet, and the market appears to be taking a similarly skeptical approach. There's still reason to believe that fiscal stimulus will be more akin to a step-up rather than a leap higher for growth. However, the risks surrounding our rate forecast are now clearly skewed to the upside given the updated Fed projections.

- Fed officials also adjusted their plan for implementing policy this time around. Instead of raising IOER (which is the top of their interest rate corridor) by 25bps, they chose to only increase it by 20bps. The move has very few implications for the overall stance of monetary policy. The fed funds effective rate had been trading at the top of the target-range rather than around the mid-point where central bankers would like to see it. As a result, this is simply an attempt to guide the fed funds effective rate towards that mid-point.

- Beginning in January of next year, each rate announcement will be followed by a press conference as opposed to the current policy of alternating meetings. While the Fed had stressed that each meeting was always 'live' in terms of the potential for a rate move, market-pricing implied that investors weren't buying it. Today's change should reinforce the Fed's message that each meeting is indeed 'live'.

- Overall, the accelerated rate hike profile has seen yields increase and the US dollar gain ground.