What to Expect From the Fed Tomorrow

December 13, 2016

- If the year's political events should teach us one thing, it's that no result is ever 100% certain. However, financial markets seem to have forgotten this lesson and are pricing in an increase in the Federal Reserve's benchmark rate with complete certainty. Recall that it's been a full year since the Fed last increased the fed funds target to 25-50 bps; a rate increase tomorrow would take the overnight interbank lending rate higher by 25 bps to 50-75 bps.
- As a result, a rate change tomorrow is likely to be met with a yawn. Instead, all attention will focus on the press conference that follows the rate announcement, alongside the release of the Fed's quarterly forecast. While September's forecast was consistent with an average of two further rate hikes in 2017, it is possible that tomorrow's forecast will embed expectations for even greater tightening in 2017 and subsequent years; alternatively, the Fed may wait until it has more clarity from the President-elect to reassess the implications for monetary policy.
- **What is the impact on commercial real estate?** Since the election, 10-year Treasury yields and swap rates have climbed by almost 65 bps—increasing financing costs and likely implying an end to further cap rate compression. While sustained rates of inflation above the Fed's 2% target haven't been an issue for the Fed in more than 8 years, the increase in implied volatility on interest rate options suggests a somewhat less clear path for future interest rates—precisely because the future path of inflation is now less certain. If nothing else, look for a wider dispersion of "assessments" made by FOMC participants of "appropriate monetary policy"—the so-called "dot plot."
- While the extent of inflationary pressure the President-elect's new policies will engender remains an unknown, tomorrow's release will provide insight into the Fed's thought process, particularly since Chairwoman Yellen has consistently said that "the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run"—which may not sit well with some members given the 3.5% gain in the Fed's broad trade-weighted dollar index since the election and an unemployment rate that is already at the level the Fed envisioned for the end of 2017.

Table 1. **Economic Projections of Federal Reserve Board Members and Presidents, September 2016**

Variable	2016	2017	2018	2019	Longer Run
	≈ ↓ ↑				
Change in real GDP, %	1.7 to 1.9 ↓	1.9 to 2.2 ≈	1.8 to 2.1 ≈	1.7 to 2.0	1.7 to 2.0 ↓≈
Unemployment rate, %	4.7 to 4.9 ↑	4.5 to 4.7 ≈	4.4 to 4.7↓≈	4.4 to 4.8	4.7 to 5.0 ≈
PCE inflation, %	1.2 to 1.4 ↓	1.7 to 1.9 ↓≈	1.8 to 2.0 ↓≈	1.9 to 2.0	2.0 ≈
Core PCE inflation, %	1.6 to 1.8 ≈	1.7 to 1.9 ↓≈	1.9 to 2.0 ≈	2.0	n/a
Fed Funds (average)	0.65% ↓	1.31% ↓	2.11% ↓	2.65%	2.91% ↓
Fed Funds (median)	0.625% ↓	1.125% ↓	1.875% ↓	2.625%	2.875% ↓

Source: Federal Reserve

Note: Excludes the three highest and three lowest projections for each variable in each year (except average and median Fed Funds rate figures, which include all participants.) Arrows (↑,↓ and ≈) indicate direction of change in forecast from June 2016 to September 2016. Real GDP and inflation projections are from Q4 of the previous year to Q4 of the year indicated. PCE inflation refers to the price index for personal consumption expenditures. Projections for the unemployment rate are for the average rate during Q4 of the year indicated.

RESEARCH CONTACT
Heidi Learner
Chief Economist
212-326-8648