

Economic Pulse

Federal Reserve | National

June 13, 2018

Fed Tightens for Second Time This Year: What's Ahead for the Balance of 2018?

The FOMC decision did not disappoint. As was widely expected, the Federal Funds rate was raised by 25 bps to a range of 1.75% to 2.0%. However, **the big surprise is that the Fed signaled its intention to raise rates by an additional two times by year-end (Table 1)**—bringing the rate to 2.25%-2.50%—and marking a significant increase from last November's 1.00%-1.25% level. Notably, should the Fed's median forecasts (which now suggest four rate hikes in 2018 and an additional three rate hikes in 2019) materialize, the terminal Fed Funds rate by the end of next year would be $\frac{1}{4}$ point above the Fed's longer-run average—suggesting a moderately *restrictive* policy.

What changed with regard to the Fed's economic projections? **GDP growth** was largely unchanged—although it is forecast to grow above its longer-run rate for the next two years. On the **inflation** front, PCE inflation is now forecast to hit 2.1% by year end (Q4 2018 vs. Q4 2017)—again, moderately above the 1.9% forecast made in March. (Chairman Powell acknowledged that some of this increase will result from recent increases in oil prices.) The unemployment rate forecast continued to be revised lower as well, although the Fed Chair was quick to point out that the lack of robust wage inflation to date has been a result of low productivity growth—which could reverse if companies use the recent tax cuts to bolster their investment spending (which ultimately, could increase potential output). Additionally, **the “forward guidance” language—which has been a mainstay of past statements—was finally removed.** No longer will the Fed Funds rate remain “for some time, below levels that are expected to prevail in the longer run.”

One other change of note: Beginning in January 2019, **the FOMC will hold press conferences after each of the eight meetings per year** (up from the four press conferences that accompany the Fed's quarterly economic projections currently.) The upshot is that moves in policy will be more likely to occur throughout the entire year —bringing greater transparency with regard to the Fed's thought process, but perhaps at the expense of more volatility surrounding the timing of any policy move.

All in all, given the “surprise rise” in Fed Funds for the balance of 2018, the market reaction has been relatively muted. Treasury yields are just 2-4 bps higher on the day, and even the equity market is taking the news in stride (although the REIT sub-index of the S&P 500 is down by 2.3% on the day vs. -0.3% for the S&P 500 as a whole.)

Table 1: Central Tendency Projections of Federal Reserve Board Members and Presidents, in % as of June 2018

Variable	2018	2019	2020	Longer Run
Change in real GDP, %	2.7 to 3.0 ≈ ↑	2.2 to 2.6 ≈	1.8 to 2.0 ≈ ↓	1.8 to 2.0 ≈
March Projection	2.6 to 3.0	2.2 to 2.6	1.8 to 2.1	1.8 to 2.0
Unemployment rate, %	3.6 to 3.7 ≈ ↓	3.4 to 3.5 ≈ ↓	3.4 to 3.7 ≈ ↓	4.3 to 4.6 ≈ ↓
March Projection	3.6 to 3.8	3.4 to 3.7	3.5 to 3.8	4.3 to 4.7
PCE inflation, %	2.0 to 2.1 ≈ ↑	2.0 to 2.2 ≈	2.1 to 2.2 ≈	2.0 ≈
March Projection	1.8 to 2.0	2.0 to 2.2	2.1 to 2.2	2.0
Core PCE inflation, %	1.9 to 2.0 ≈ ↑	2.0 to 2.2 ≈	2.1 to 2.2 ≈	n/a
March Projection	1.8 to 2.0	2.0 to 2.2	2.1 to 2.2	n/a
Fed Funds (average)	2.24% ↑	2.96% ↑	3.31% ≈ ↓	2.87% ≈
March Projection	2.19%	2.92%	3.33%	2.87%
Fed Funds (median)	2.38% ↑	3.13% ↑	3.38% ≈	2.88% ≈
March Projection	2.13%	2.88%	3.38%	2.88%

From the FOMC Press Release

Labor Market

May: “The labor market has continued to strengthen... job gains have been strong, on average, in recent months, and the unemployment rate has stayed low.”

June: “The labor market has continued to strengthen...job gains have been strong, on average, in recent months, and the unemployment rate has declined.”

Recent Data

May: “Growth of household spending moderated from its strong fourth-quarter pace, while business fixed investment continued to grow strongly.”

June: “Growth of household spending **has picked up**, while business fixed investment has continued to grow strongly.”

Inflation

May: “On a 12-month basis, both overall inflation and inflation for items other than food and energy have moved close to 2 percent. **Market-based measures of inflation compensation remain low**; survey-based measures of longer-term inflation expectations are little changed, on balance.”

June: “On a 12-month basis, both overall inflation and inflation for items other than food and energy have moved close to 2 percent. Indicators of longer-term inflation expectations are little changed, on balance.”

Policy Stance/Future Bias

May: “The Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant further gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.”

June: Statement removed.

MARKET CONTACT

Heidi Learner | Chief Economist

hlearner@savills-studley.com

212-326-8648

