First Trust
ECONOMIC RESEARCH REPORT
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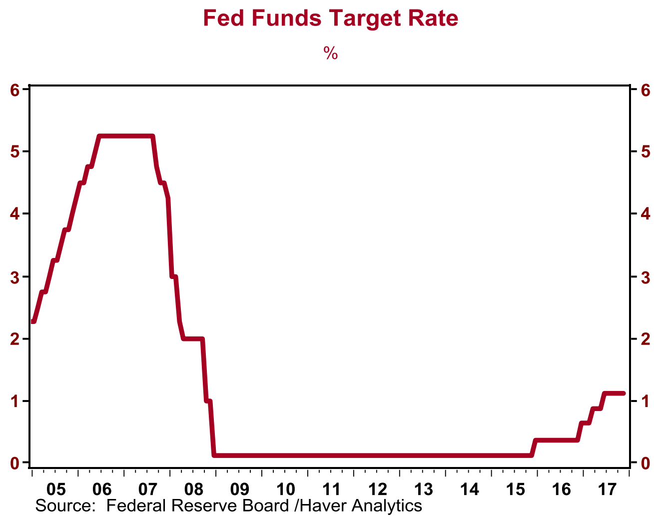
Fed Resists the Doves

The after effects of hurricanes Harvey, Irma, and Maria have done little to sway the opinion of Federal Reserve members that the economy is ready for further rate hikes. While leaving rates unchanged at today's meeting - as expected - they set the table for December. The Fed essentially waved off the hurricane-related September payrolls declines, and more notably strengthened rhetoric about economic growth, which they now characterize as "rising at a solid rate" compared to September's "rising moderately." Meanwhile the Fed added text noting a pickup in business fixed investment over recent quarters. In fact, it's hard to find much in today's statement that would put a December rate hike in doubt.

Despite the hawkish tone of the statement, market odds of a December rate hike were little changed following the statement, moving to 87.5% from 82.8% two days ago. That said, just two months ago the markets had 34.5% odds on a third rate hike in 2017. Looking further ahead, markets are pricing in one to two rate hikes in 2018. We think three hikes next year more likely, as improved economic and tax policy out of Washington push economic growth higher.



In the meantime, the Fed will continue to reduce its balance sheet at a pace of up to $10 billion per month for the fourth quarter, increasing that to $20 billion monthly pace in the first quarter of 2018, $30 billion in Q2, $40 billion in Q3, and $50 billion in Q4. After that, the Fed is projecting it would maintain that $50 billion monthly pace until it's satisfied with the size of the balance sheet. (For the foreseeable future, the balance sheet cuts would be 60% in Treasury securities and 40% in mortgage-related securities.)

With today's statement in the books, focus is now on President Trump's announcement of the next Federal Reserve Chair, expected later this week. According to reports from the Wall Street Journal, current Fed Governor Jerome Powell will be nominated for the position, beating out Vice President Mike Pence's top choice (and ours too), Stanford Professor John Taylor. The question now is if Taylor will be selected to fill the Vice-Chair position left open following Stanley Fischer's departure in October.

There were no dissents from today's statement, not even Minneapolis President Neel Kashkari, who has made dovish comments and voiced dissent to further rate hikes as recently as June. It appears the Federal Open Market Committee is in agreement that the improved outlook for the economy - and expectations of inflation rising towards the Fed's 2% target - justify the continued steady process of making monetary policy a little less loose.

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Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in September indicates that the labor market has continued to strengthen and that economic activity has been rising at a solid rate despite hurricane-related disruptions. Although the hurricanes caused a drop in payroll employment in September, the unemployment rate declined further. Household spending has been expanding at a moderate rate, and growth in business fixed investment has picked up in recent quarters. Gasoline prices rose in the aftermath of the hurricanes, boosting overall inflation in September; however, inflation for items other than food and energy remained soft. On a 12-month basis, both inflation measures have declined this year and are running below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Hurricane-related disruptions and rebuilding will continue to affect economic activity, employment, and inflation in the near term, but past experience suggests that the storms are unlikely to materially alter the course of the national economy over the medium term. Consequently, the Committee continues to expect that, with gradual adjustments *in the stance of monetary policy, economic activity will expand at a moderate pace, and labor market conditions will strengthen somewhat further. Inflation on a 12-month basis is expected to remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term. Near-term risks to the economic outlook appear roughly balanced, but the Committee is monitoring inflation developments closely.*

In view of realized and expected labor market conditions and inflation, the Committee decided to maintain the target range for the federal funds rate at 1 to 1-1/4 percent. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2 percent inflation.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. 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 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.

The balance sheet normalization program initiated in October 2017 is proceeding.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Charles L. Evans; Patrick Harker; Robert S. Kaplan; Neel Kashkari; Jerome H. Powell; and Randal K. Quarles.