First Trust
ECONOMIC RESEARCH REPORT

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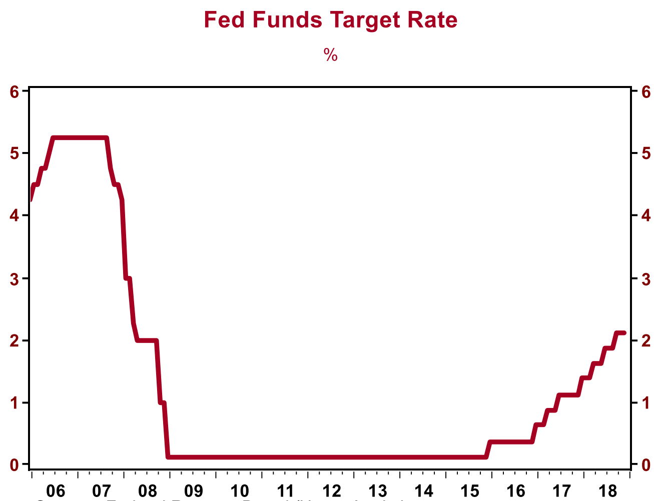
Stay the Course

No fireworks in today's FOMC statement, as Chairman Powell and company held rates steady while reinforcing their outlook. Unemployment remains low, household spending remains strong, and inflation is running in-line with their 2% inflation target. In other words, today's near unanimously expected pause looks almost certain to be followed by a rate hike at the December meeting.



Source: Federal Reserve Board /Haver Analytics

In the meantime, the Federal Reserve continues to shrink its balance sheet at a measured pace of $50 billion per month (comprised of $30 billion in Treasuries and $20 billion of agency and mortgage backed securities rolling off monthly). That said, the Fed balance sheet still exceeds $4 trillion – compared to roughly $900 billion before the implementation of QE – and the very modest pace of "normalization" is unlikely to have any material impact on the markets. And with more than $1.7 trillion in excess reserves in the system and nominal economic growth (which includes real GDP growth and inflation) averaging 4.8% over the past two years, monetary policy remains far from tight. In recent weeks, the long-term "normal" size of the balance sheet has become a more frequent topic of Fed conversation, and we wouldn't be surprised to see guidance later this year or early next on both how long the normalization process will take and what the final balance sheet size may look like, though – in typical Fed fashion – expect the wording to allow plenty of wiggle room.

Looking forward, the mid-December meeting of the FOMC will get plenty of attention. In addition to an expected rate hike, the Fed will provide updated economic projections that show their best guess at how far rates will rise in 2019. While we believe four rate hikes are warranted – the same pace as 2018 if a December hike holds true – we expect the Fed will continue to signal expectations for three hikes, and will subsequently revise expectations higher in mid-2019 as they see sustained economic growth, just as they did in 2018.

Some in the media will argue that recent market volatility justifies a slower pace of hikes from the Fed, but we say phooey. The midterm elections raised emotions, but did virtually nothing to change the outlook for an economy on track to show the fastest annual pace of growth in more than a decade. A split Congress means no further tax cuts, but that tax rates won't be raised either. Rhetoric will continue to escalate, but so too will corporate profits. Neither party has the votes needed to make drastic legislative changes, but – with the tax cuts and deregulation already in place - no changes are needed for this economy (and the Fed) to stay the course through 2019.

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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 strong rate. Job gains have been strong, on average, in recent months, and the unemployment rate has declined. Household spending has continued to grow strongly, while growth of business fixed investment has moderated from its rapid pace earlier in the year. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2 percent. Indicators 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. The Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. Risks to the economic outlook appear roughly balanced.

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 2 to 2-1/4 percent.

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 maximum employment objective and its symmetric 2 percent inflation objective. 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.

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chairman; John C. Williams, Vice Chairman; Thomas I. Barkin; Raphael W. Bostic; Lael Brainard; Richard H. Clarida; Mary C. Daly; Loretta J. Mester; and Randal K. Quarles.