First Trust
ECONOMIC RESEARCH REPORT

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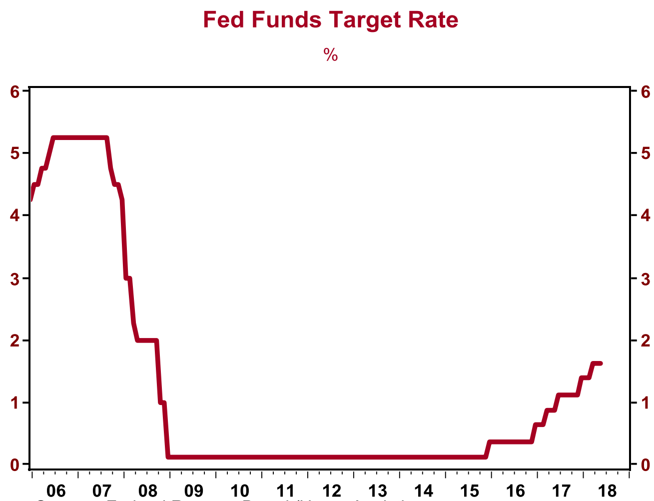
Fed on Track for Four

The Federal Reserve held interest rates unchanged following today's meeting, but also left a few clues that they see economic activity and inflation heating up more than previously projected. A rate hike in June looks all but set in stone, and today's statement is consistent with two more rate hikes in the second half of the year, for a total of four hikes in 2018.



Source: Federal Reserve Board /Haver Analytics

In the statement following the meeting, the Fed noted that job gains have continued to remain strong "on average," - acknowledging the unusually large increase in February followed by the tepid March report - while also highlighting continued strong growth in business fixed investment. Meanwhile, language was once again upgraded in relation to inflation. In the March statement, the Fed changed their projection for moving towards the 2% target from "this year" to "in coming months." With recent data on the PCE price index showing a 2% year-to-year increase in March, the Fed today appropriately removed wording about running below the target all together, and now expects inflation to "run near" the target over the medium term.

What is likely to get the most news coverage from today's statement is the addition of the word "symmetric" when talking about the risk of inflation. While previously the "risk" of inflation was that it was running low, the risk of inflation running high now also warrants Fed watching. We think this "symmetric" wording is a signal that the Fed plans to keep a steady pace of 25 basis point rate hikes (think once every other meeting), meaning four hikes this year and four in 2019.

Markets, meanwhile, have come around to a more aggressive view on the Fed raising rates. Back on March 21st, the day of the last Fed statement, markets were pricing in a 37% chance of four or more hikes in 2018. Now the odds are 49%, and moving higher with each passing week.

We will get a better read on the Fed's viewpoint for the remainder of the year following the June meeting, when the Fed releases updated economic projections and Chair Powell will hold a press conference. In the meantime, the Fed will continue reducing its balance sheet at a pace of up to $30 billion per month, increasing that to $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.)

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Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in March indicates that the labor market has continued to strengthen and that economic activity has been rising at a moderate rate. Job gains have been strong, on average, in recent months, and the unemployment rate has stayed low. Recent data suggest that growth of household spending moderated from its strong fourth-quarter pace, while business fixed investment continued to grow strongly. 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.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with further gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace in the medium term and labor market conditions will remain strong. Inflation on a 12-month basis is expected to run 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 1-1/2 to 1-3/4 percent. The *stance of monetary policy remains accommodative, thereby supporting strong 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 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.

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