First Trust ECONOMIC RESEARCH REPORT

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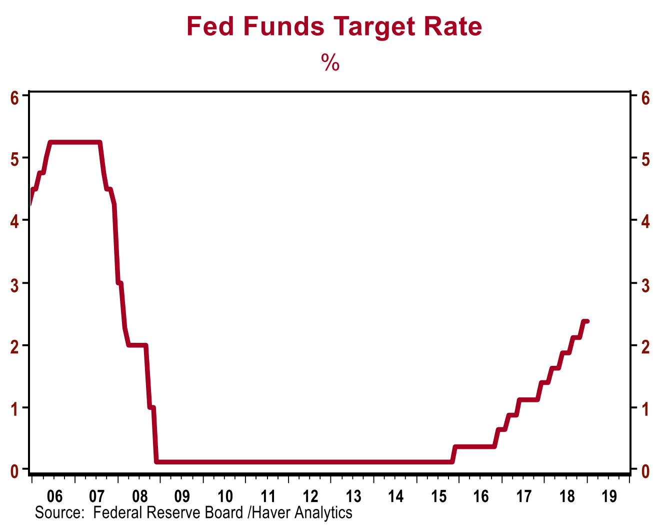
Patient Powell

The Doves won the day at the Federal Reserve today, which noted continued solid economic performance but removed longstanding language that further gradual increases will be warranted, and instead highlighted global developments – both economic and financial - and a moderation in inflation as reasons the Fed will be "patient" in determining the pace of future rate hikes. This is an important change in tone. That said, arguably the most important comments from the Fed today came outside the FOMC statement.



At the same time as the FOMC release, the Fed published a statement regarding balance sheet normalization and the path back towards "normal." Two items of note came from this second release: 1) the Fed stated that they are prepared to adjust the normalization policy – both in terms of the monthly pace of roll-offs and final balance sheet size - in light of economic developments, and 2) they confirmed that they view balance sheet adjustments (think QE) as a tool they will continue to use in the future in addition to changes to the Fed Funds rate.

Chair Powell himself doubled-down on the dovish tone in his press conference following the release (remember, the Fed Chair will now hold a press conference following each statement, up from once per quarter). In particular, he emphasized that a slowdown in global growth paired with uncertainty surrounding trade, another government shutdown, and Brexit negotiations have put the Fed into wait and see mode. Current rates, he said, are appropriate given the economic and political environment, and he now wants to see a need for further rate increases, while prior meetings suggested the Fed had rates gradually rising on autopilot unless they saw reason to pause.

Short-term jitters can test the most stoic of wills, and Powell's fortitude is being tested. But fundamentals are what move the economy – and markets – over the long term. And the fundamentals, fueled by entrepreneurship, deregulation, and the tax cuts, continue to point higher.

We continue to believe monetary policy remains far from tight, and that economic activity, by itself, would warrant four hikes this year. However, the Fed wrongly fears an inverted yield curve and is unlikely to raise rates again until the 10-year yield reaches 3.00%. If the economy performs as we expect and if the 10-year yield rises to 3.4%, as well, the Fed should ultimately end up raising rates at least twice, and perhaps three times, in 2019.

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Text of the Federal Reserve's Statement:

Information received since the Federal Open Market Committee met in December indicates that the labor market has continued to strengthen and that economic activity has been rising at a solid rate. Job gains have been strong, on average, in recent months, and the unemployment rate has remained low. Household spending has continued to grow strongly, while growth of business fixed investment has moderated from its rapid pace earlier last year. On a 12-month basis, both overall inflation and inflation for items other than food and energy remain near 2 percent. Although market-based measures of inflation compensation have moved lower in recent months, survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

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; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren.