

"Data dependent"

Blog

While it had become something of a closer call in recent weeks due to both a softening in the economic data and increased volatility within equity markets, the FOMC opted to raise the target federal funds rate by 25 basis points at Wednesday's meeting, as expected. This marks the ninth rate hike since the Federal Reserve first began the process of policy "normalization" three years ago, and the eighth rate hike in the last eight quarters. But while the Fed elected to ratchet the funds rate up once again, it also signaled that the once-per-quarter pace of the last two years has ended and the pace of additional rate hikes will be more dependent on the outlook for growth and inflation in the months ahead.

In addition, the dots – which reflect the forward-looking rate forecasts of individual FOMC members – shows a bit of a shift in policy views, with the median dot now signaling just two more rate hikes over the course of 2019 and one in 2020. While this is still above what markets have been pricing in (as reflected by the fed funds forward curve), it does indicate a less aggressive pace of hiking than the Fed's prior forecasts of three hikes in 2019 and one in 2020.

Despite a less aggressive path of rate hikes from the Fed and a clear emphasis from Chairman Jay Powell that the Fed will be "data dependent," the S&P 500 sold off more than 2.5% after the statement was released. Market participants may have been disappointed that the Fed did not explicitly suggest a pause in its rate hiking campaign. Still, the statement from the Fed acknowledged the recent volatility in financial markets. And, in his press conference, Powell indicated that market participants appear to be concerned that there are risks to the growth outlook. This should give investors some comfort that the Fed will continue to reduce its rate hiking plans if growth does, in fact, disappoint.

Investor attention will now shift back to economic and corporate fundamentals. While both economic and corporate profit growth are slowing from elevated to more "normal" levels, there are scant signs that the economy is on the cusp of a recession. Similarly, we think the risk that trade frictions between the US and China result in an abrupt deceleration in economic activity is overstated.

We continue to believe that the recent sell-off in equity markets reflects far too much pessimism about the outlook, and expect equities globally will rebound over the next six months. But markets are also likely to remain volatile in the near term as investors wait for clear evidence that their concerns about slowing economic and earnings growth are misplaced.

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Appendix

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Version as per April 2018.

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