S&P Global
Ratings

RatingsDirect®

S&P Global Expects The Federal Reserve To Pick Up The Pace Of Rate Increases To Four Hikes In 2018

U.S. Chief Economist:
Beth Ann Bovino, New York (1) 212-438-1652; bethann.bovino@spglobal.com

U.S. Senior Economist:
Satyam Panday, New York + (212) 438-6009; satyam.panday@spglobal.com

Media Contact:
Jeff Sexton, New York (1) 212-438-3448; jeff.sexton@spglobal.com

NEW YORK (S&P Global Ratings) March 22, 2018--The outlook for the U.S. economy continues to strengthen, though growth rates for household and business spending have moderated somewhat from a very strong fourth quarter. Labor demand remains solid, and there are signs that inflation is perking up. Inflation--as measured by the core personal consumption expenditure (PCE) index--remains subdued for now, at 1.5%, but expectations of it moving closer to the 2% target are rising, given the tightening jobs market and increased economic activity.

According to the updated summary of economic projections released Wednesday after the March Federal Open Market Committee (FOMC) meeting, a few more participants now expect three or more rate hikes by year-end (according to the "dot plot"), though that wasn't enough to move the median forecast away from its current three hikes. Despite the Fed's near-term outlook for only three rate increases, we believe the Fed will likely raise rates slightly faster, with four rate hikes in total this year. This takes into account a stronger near-term economic outlook, helped by fiscal spending at a time when the U.S. output gap has closed.

Our view is supported by February's healthy job gains, a solid round of economic data in the fourth quarter when domestic demand increased 4.3% (the strongest since 2014), and the statement from the most recent FOMC meeting. In the statement following the March meeting, to no one's surprise, the Fed raised rates--by 25 basis points--in March to 1.5%-1.75% (as we had expected). It also struck an optimistic tone, saying the "economic outlook has strengthened in recent months," which is in line with FOMC participants' higher near-term GDP forecasts.

Both the FOMC statement and Chairman Jerome Powell's press conference (where he noted the flatness of the Phillips Curve--the relationship between inflation and unemployment) indicated a sanguine inflation outlook. This was somewhat of a surprise given Fed median forecasts indicated stronger growth. Participants nudged their forecast for core PCE inflation higher for 2019 and 2020--reflecting a bit of an overshoot of their inflation target and another reason the Fed would likely want to pick up the pace this year.

The statement revealed additional confidence in the inflation outlook by dropping the reference to low near-term inflation in place of an expectation that inflation will rise this year. The statement noted that market measures of inflation compensation "increased in recent months." It appears that the Fed is less concerned that the shortfall in inflation will be persistent.

In addition, there were some revisions that hint to continuing rate hikes. Specifically, it added the word "further" to convey the message that the committee expects conditions to evolve in a manner that "will warrant further gradual increases in the federal funds rate." Also, median projections of interest rate hikes nudged up to three rate hikes in 2019 to 2.9% and another two in 2020 to 3.4% (was 3.1% in December), while its estimate of the neutral long-term rate was raised slightly to 2.9% from 2.8%.

opinions about relative credit risk provide market participants with information that helps to support the growth of transparent, liquid debt markets worldwide.