Fed hikes rates for second time since crisis

The central bank expresses a more hawkish view than expected for 2017

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The Federal Reserve (Fed) raised interest rates today by 0.25%, only the second rate hike since the global financial crisis in 2008, to a range of 0.5% to 0.75%. The statement that accompanied the policy meeting reflected signs of a stronger labor market, moderate growth and improving inflation. Additionally, the Fed noted that it views risks to the economy as ăroughly balancedĄ.

The Fed's summary of economic projections showed modest improvement in its expectations for gross domestic product (GDP) growth and the unemployment rate. Probably the most surprising change was the increase in the expected number of future rate hikes, which was changed from two to three in 2017. The Fed maintained its forecast of three hikes in 2018 and 2019. Fed Chair Janet Yellen acknowledged that potential changes in fiscal policy were taken into account in the Fed's economic projections. However, she noted that the change in the Fed's forecast of policy rates (the so-called dots) was modest. Overall, Ms. Yellen's statements were perceived as hawkish by the markets, in our view, largely due to the changes in the policy rate forecasts.

The Fed statement continued to express that economic conditions will likely warrant "only gradual increases in the federal funds rateĄ. However, Ms. Yellen mentioned that a fiscal boost is "not obviously needed for full employment" and that she does not favor running a "high-pressured" economy. When asked about the reaction of financial markets since Donald Trump's election as US president, Ms. Yellen stated that the rate of return of stocks remains within a normal range, and the Fed has time to see what policy changes occur.

We at Invesco Fixed Income continue to believe that the Fed will remain somewhat cautious until the new administration is in place and has more specific policy proposals on the table. Developments on fiscal policy and the Fed's response will be key to markets, in our view, as Ms. Yellen has made it clear that the Fed is not willing to let the economy become significantly overheated.

Looking ahead to the next Fed meeting

The next Fed meeting is scheduled for Feb. 1, 2017. However, we do not believe another Fed hike is in the cards until after the first quarter of 2017. We believe the Fed's statement today should be viewed as neutral to slightly negative for equity and bond markets, as the Fed was slightly more hawkish than we would have expected. We believe today's events should also result in a stronger US dollar.

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