Fed hikes short-term rates for third time in 15 months

Fed's constructive growth and inflation outlook likely paves the way for further hikes

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March 2017

The US Federal Reserve (the Fed) hiked its benchmark short-term interest rate by 25 basis points today, as expected. The statement was generally neutral, in our view, with upbeat commentary around the current growth backdrop. Inflation commentary was more mixed, stating that headline inflation has moved closer to the Fed's target, yet emphasizing that core inflation continues to run below the Fed's target. Overall, the statement was similar to the January—February statement, meaning that little has changed to alter the Fed's view since then.

The Fed also released its widely anticipated Summary of Economic Projections (SEP), which includes the forecast of the federal funds rate or the so-called "dots." The projected year-end 2017 federal funds rate indicates three rate hikes, unchanged from December's SEP release, while the bond market had only been pricing in two prior to today's announcement.[1] The longer-run federal funds rate was unchanged at 3.0%. Growth and inflation projections were largely unchanged with only a slight upward revision to 2017 core inflation, from 1.8% to 1.9%.[2]

In her press conference, Fed Chair Janet Yellen stated that an unchanged SEP is consistent with gradual rate increases over time. The Fed is discussing and monitoring fiscal policy changes but has not yet included potential impacts in its projections. Therefore, federal funds rate projections were left unchanged.

Looking ahead

Given our constructive outlook for global growth, our base case view has been that the Fed will likely hike rates three times in 2017. We expect the bond market to continue to converge toward this view. We believe that risk assets will continue to be supported by a better global growth picture. If the market abruptly begins to price in more than three Fed hikes (four or more) or it believes that the Fed is behind the curve (meaning that it believes the pace of rate hikes is too slow), we would look to scale back this view, as this concern could lead to a risk-off environment.

[1] Source: Bloomberg L.P., March 15, 2017.

[2] Source: federalreserve.gov, March 15, 2017.

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