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Eye on the Federal Reserve

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The Federal Reserve Federal Open Market Committee released their most recent statement on monetary policy today. In it, the Fed determined to increase the federal funds rate to a range of 1.5 to 1.75%, an increase of 0.25%. This was the first rate hike in 2018 after the Fed held the key rate steady at their January meeting. This is also the first meeting chaired by Jerome Powell, who takes over the task of unwinding unprecedented monetary stimulus from former chair Janet Yellen.

Beyond the headline decision on the fed funds rate, investors will tear apart the minutes to see what the specific language and changes from the prior statement imply about future Fed policy and key risks like inflation or an overheating economy.

The main changes in the language regard the Fed's view of the strength of the economy. The Fed both acknowledged that the rate of economic growth has moderated from the fourth quarter and that the outlook for economic growth has strengthened in recent months. This expectation of a strengthening economy likely drove expectations for additional rate increases in 2019 and 2020 (as indicated by the projection materials released with the statement). Expectations remain for two additional rate increases in 2018, but the estimate for 2019 now suggests three increases instead of two, and the estimate for 2020 suggests two increases instead of one. The long run rate estimate remains unchanged.

While changes to the statement are important, non-changes can be just as telling. For this statement, the key non-changes regard the Fed's view on inflation. None of the language regarding the outlook for inflation changed, which is particularly important as the market selloff

in February was arguably the result of elevated wage inflation readings in the unemployment report. The Fed continues to expect inflation to move up to 2%, which is the policy objective over the medium term. There is no indication in the statement or in the projection materials that the Fed expects inflation to overshoot.

What Does This Mean for Investors?

In general, I view the Fed statement positively. It confirms that the economy continues to strengthen, but at the same time the Fed is not signaling any panic with regard to inflation spiraling out of control or the economy overheating. In short, they are not yet taking away the punch bowl. That signals a continuing orderly increase in short term rates, which should provide some certainty for businesses as it's much easier to plan around a clearly signaled rate path than a policy which suggests control has been lost. It also means rates should remain accommodative for consumer spending.

When it comes to Fed policy, surprises are a bad thing, and this statement lacked surprises and was generally in line with market expectations.

The Federal Open Market Committee will meet again in early May.

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