ECONOMIC NEWS

What signals will the Federal Reserve send about what's coming next?

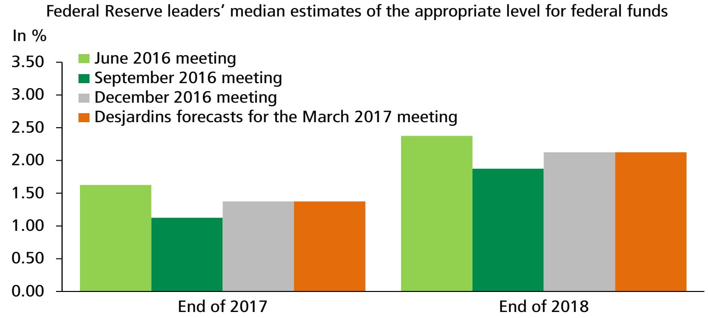
The good job market figures released last Friday ended the debate. It now seems certain that the Federal Reserve (Fed) will increase its key rates by 0.25% at the meeting that ends on Wednesday—a second consecutive quarterly increase. Investors do not seem to think that monetary tightening will continue at this pace. Federal funds futures are only pricing in a 60 basis point increase by year's end, including March's increase, with a similar rise in 2018. These expectations may have to adjust if the Fed signals faster firming.

The Fed's statement should feature a relatively positive tone and continue to signal gradual key rate increases, while staying vague on the details. Fed leaders' estimates about appropriate federal funds rate levels could send a clearer message, however. Last December, the leaders' midpoint forecast had gone up to signal a 0.75% increase in rates in 2017. If it goes up again to signal a total increase of 1.00% in 2017, that would indicate that most Fed leaders now expect rates to increase every quarter, if the economic situation evolves as predicted, making a June increase very likely.

We expect, however, that leaders' estimates will not change much this time. Firstly, note that, in September, a majority still thought that a key rate increase of just 0.50% would be appropriate in 2017. The developments with inflation and the job market have been generally positive since then, but the levels projected in September for inflation and unemployment at the end of 2017 and in 2018 remain perfectly valid. Moreover, several leaders recently stated that a scenario of three key rate increases in 2017 seems appropriate. Disappointing U.S. GDP growth at the start of 2017, limited wage pressures and the major persisting uncertainties about the measures the new U.S. administration will institute also argue for patience before signalling more aggressive monetary firming.

GRAPH

Federal Reserve leaders should not signal faster monetary policy firming



Sources: Federal Reserve and Desjardins, Economic Studies

IMPLICATIONS

Due to the job market's strength, upswing by inflation and encouraging levels posted by several leading indicators, we are expecting three 0.25% key rate increases this year, and in 2018. Even a third consecutive quarterly increase in June and a pace of four rate increases per year are now possible. Numerous uncertainties persist, however, and we expect that most Fed leaders will want to avoid creating a shock in the markets by immediately signalling faster monetary tightening.

Mathieu D'Anjou, CFA, Senior Economist

François Dupuis, Vice-President and Chief Economist • Mathieu D'Anjou, Senior Economist
Benoit P. Durocher, Senior Economist • Francis Généreux, Senior Economist • Jimmy Jean, Senior Economist • Hendrix Vachon, Senior Economist
Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics