What Can We Expect from the Federal Reserve This Week?

The Federal Reserve (Fed) seems set to announce a new key rate hike on September 26. In June, Fed leaders signalled that two more rate hikes of 0.25% would likely be appropriate in the second half of 2018, an assessment backed by the favourable economic data released over the past few months. The faster wage growth revealed in the most recent job market statistics also weighs in favour of continued monetary tightening.

While the tone of the statement should stay fairly upbeat, investors will be watching mainly for changes in the Fed leaders’ estimates of the appropriate level for key rates in the coming years. The leaders’ median estimates have gone up in recent quarters, and now point to a total of four 0.25% hikes in 2018 and another three increases in 2019. It would be surprising if September brought any changes for these two years, especially since the economy seems to be growing in line with what the Fed leaders predicted last June.

However, there could be a slight change in the level estimated for the end of 2020 and, in particular, the long term. Even if the other leaders do not change their forecasts, the arrival of a new Fed Vice Chairman (with Richard Clarida replacing Stanley Fischer), could be enough to change the median estimate of the appropriate long-term federal funds rate. That estimate, which is equivalent to the neutral rate, could easily swing from 2.875% to either 2.750% or 3.000%. The Fed may also drop from its statement the mention that the stance of monetary policy remains accommodative as key rates get closer to the neutral rate. None of those changes should be seen as strong indicators of what to expect from the Fed, however. Jerome Powell and other Fed leaders have recently seemed to downplay the importance of neutral rate estimates as a guide for monetary policy.

**IMPLICATIONS**

Most Fed leaders still seem comfortable with the idea of continuing monetary tightening by raising key rates 0.25% per quarter for some time to come. Even though slight changes may be made to this week’s statement and to leaders’ forecasts, it would be surprising if they signalled a real challenge of that consensus. A change in the number of hikes for 2018 or 2019 would be a real surprise, however, and the bond market would likely react strongly.

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