

# Market Backlash

The Treasury market had priced in a 25-basis-point increase in the FOMC's target range for federal funds prior to the FOMC's December 18–19 meeting. The Committee was faced with essentially three policy options: Pause, deliver on the 25-basis-point increase and signal a pause, or deliver on the 25-basis-point increase and signal the willingness to continue raising rates.



The decision was a 25-basis-point increase in the target range and a signal that the most likely path for 2019 included two more rate moves. Until the announcement and subsequent press conference, the Dow was up 300 points, but it plunged into negative territory when the FOMC delivered on what turned out to be a modified version of the third option. That market funk continued the next day. Markets clearly wanted a strong signal that the FOMC would pause in 2019, and traders weren't mollified by the generally moderate tone struck by Chairman Powell in his press conference.

Different people took different messages away from the press conference. First, when asked what role recent market turmoil played in the FOMC's decision, Powell said – consistent with long-standing Fed policy – that market turmoil was not a defining consideration, a view that was received negatively by the market, despite the fact that Powell went on to elaborate that the FOMC looks at many considerations, including global issues, concerns about tariffs, the declining impact of the tax cut and financial market conditions more broadly. That clarification apparently fell on deaf ears.

Second, when questioned about the impact of the president's recent tweets, Powell did not state that the president, like other citizens, has a right to his personal opinions. Rather,

he issued the emphatic statement that the Fed was independent and would do what it felt needed to be done, free from political considerations. Clearly, the president's tweets were not well received by the FOMC.

Third, Powell noted that the policy rate was at the low range of what the Committee viewed as neutral and that financial conditions continued to be accommodative in the context of a growing economy, strong labor markets, and an inflation outlook near the Committee's target. He went on to try to dispel the view that two rate hikes were a given for 2019. He emphasized that the Committee would be driven totally by incoming data. Again, markets didn't hear him.

What is the Committee expecting as far as those data are concerned? The SEP forecasts clearly showed that median growth had been marked down for both 2018 and 2019; and the central tendencies for both 2018 and 2019 were also marked down. There was virtually no change in the unemployment forecasts; and PCE headline inflation forecasts had softened somewhat, while PCE core forecasts were essentially unchanged for 2019, at the target rate of 2%.

If those forecasts are realized, there will likely be, at most, two policy moves in 2019. Moreover, the chairman's message was clear: The Committee will not do anything stupid. Chairman Powell emphasized that the Committee could be patient and is not wedded to any particular path.

The keys to both timing and amount will be incoming data on growth and inflation. Given that, when might we expect the next rate hike, if it is deemed justified? Monthly data will be available on PCE, but only quarterly data will be available on growth. More importantly, the FOMC will not receive data on Q4 2018 until January 30, but that is likely to be stale news given what is already known about economic performance in 2018. More relevant is that Q1 2019 GDP will not be available until the Committee's April meeting, and Q2 GDP will not be

available until its July meeting. This timeline suggests that the most likely time for the first rate hike, if it is to occur, would be at the Committee's April meeting. Having said that, a patient FOMC could reasonably wait to make its first rate move in 2019 until its July meeting, where it would have readings on several months of employment and inflation data and readings on growth for the first half of 2019. It is worth repeating, the Committee is clear that it will not do anything stupid.

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