

# The Fed sees inflation overshooting its target in 2019

22 March 2018

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- > The FOMC raised the federal funds target range by 25 basis points to 1.50-1.75%.
- > The median dots indicate an additional 8 cumulative hikes from 2018 to 2020.
- > FOMC members expect an overshoot of core PCE inflation in 2019 and 2020 at 2.1%.
- > The market interpretation has been “dovish”. We continue to expect four rate hikes this year.

> **The interest rate decision:** as widely expected, the Fed raised the target range for the federal funds rate by 25 basis points to 1.50-1.75%. The decision was unanimous. Of note that the two dissenting members that voted against an interest rate hike in December, namely Chicago Fed Evans and Minneapolis Fed Kashkari, are not voting members this year in the Federal Open Market Committee (FOMC).

In the statement, economic activity was downgraded from “solid” to “moderate”, reflecting a weak start to the year for retail sales and housing data. However, the general outlook is considered to have strengthened in recent months and the **rebound in inflation is expected in the coming months.**

> **The economic projections:** median GDP growth projections have been revised upwards for 2018 and 2019 by a cumulative 0.5 percentage point with all FOMC members including the impact of the fiscal reform, the spending bills and firming global growth. **Core PCE inflation has been revised upwards for 2019 and 2020 to 2.1%. This is the first time that FOMC members expect an overshoot of the core PCE inflation target of 2% and the most hawkish change in the projections.** The unem-

ployment rate has been revised downwards over the forecast horizon, as well as the NAIRU at 4.5%.

> **The dots:** for 2018 three FOMC members moved their forecast above the median but one more was needed to move the median dot at four hikes for the year. **One more rate hike is now projected for 2019 and 2020 for an additional 8 hikes in the next 30 months.**

> **The press conference:** we judge Fed Chair Powell tone as very balanced. He mentioned that there is “no sense in the data that we are on the cusp of an acceleration of inflation”. The inflation forecasts also suggest a temporary deviation from the 2% target.

> **Market reaction:** investors price in an additional 54 basis points increase in fed funds rate by year-end (2 hikes). Equities traded marginally weaker after an initial rally on the news that the median dot did not move for 2018. The yield curve shifted slightly downwards, an indication that investors saw the FOMC meeting as less hawkish than anticipated.

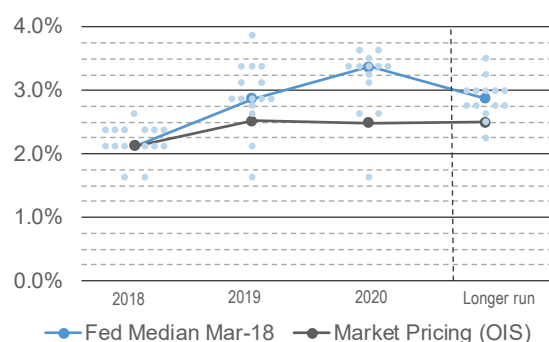
> **Asset allocation:** the meeting is in line with our view that the Fed will increase the fed funds rate four times this year and that inflation will rise gradually towards its 2% inflation target. We remain underweight sovereign bonds with a short duration. We continue to favour US equities with a bias on the technology, industrial and materials sectors.

**INFLATION TO OVERSHOOT THE FED'S TARGET IN 2019 AND 2020**

	2018	2019	2020	Long run
<b>Change in Real GDP</b>	<b>2.7%</b>	<b>2.4%</b>	<b>2.0%</b>	<b>1.8%</b>
<i>December projections</i>	2.5%	2.1%	2.0%	1.8%
<b>Headline PCE Inflation</b>	<b>1.9%</b>	<b>2.0%</b>	<b>2.1%</b>	<b>2.0%</b>
<i>December projections</i>	1.9%	2.0%	2.0%	2.0%
<b>Core PCE Inflation</b>	<b>1.9%</b>	<b>2.1%</b>	<b>2.1%</b>	
<i>December projections</i>	1.9%	2.0%	2.0%	
<b>Unemployment Rate</b>	<b>3.8%</b>	<b>3.6%</b>	<b>3.6%</b>	<b>4.5%</b>
<i>December projections</i>	3.9%	3.9%	4.0%	4.6%

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**MEDIAN DOT FOR 2019 AND 2020 MOVED UP BY 25 BASIS POINTS**



Sources: Federal Reserve, Bloomberg, Mirabaud Asset Management