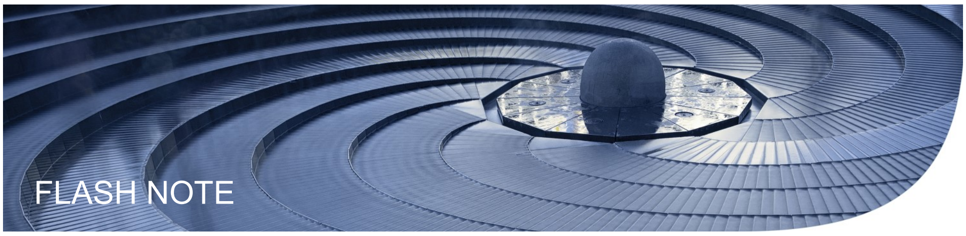



# Fed: the pace of rate normalization gains traction

14 June 2018

Strategy Team

**A hawkish Fed** raised the target range for the federal funds rate by 25 basis points to 1.75-2.00%.

The Fed **raised its median dot for 2018 to four rate hikes** and for 2019 to three.

Monetary policy normalization gains traction. Inflation risk is clearly on the upside in our view. Upwards revision to growth projections.

> The interest rate decision: **the FOMC raised the target range for the federal funds rate by 25 basis points to 1.75-2.00%**. For technical reasons—the effective fed funds rate has been trading closer to the upper bound of the range since March due to higher Treasury bill issuance and declining reserves—the interest rate on excess reserves has been raised by 20 basis points only.

> The policy statement: the statement was more hawkish than expected. The FOMC upgraded its assessment of current economic developments (solid growth, declining unemployment, pick up in spending). Though the current stance of monetary policy remains accommodative, **the Committee removed the commitment to hold rates low for long**, a move that was signaled in the minutes of previous meeting and by some FOMC members in recent speeches.

> Economic projections: **the Fed raised its median dot for 2018 to four rate hikes and to three rate hikes for 2019, in line with our own forecasts**. These changes are motivated by upwards revisions to growth and inflation—both headline and core—for 2018 and a lower unemployment rate. The equilibrium unemployment rate (NAIRU) was left unchanged, signaling expectations of further wage pressures.

> The press conference: starting in January 2019, press conferences will occur at every meeting. This change should not be interpreted as hawkish but will offer more flexibility to adjust the federal funds rate. **The overall message was resolutely optimistic with no particular reference to political risk in Italy or trade risk.**

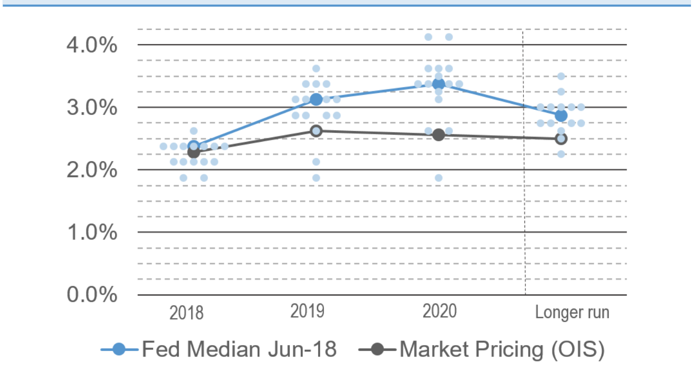
> Asset allocation: this hawkish monetary policy meeting is in line with our baseline scenario which foresees two rate hikes in September and December, and three additional rate hikes in 2019. Due to stronger economic activity and a tighter labor market, **inflation is likely to rise above expectations, in our view, with upside risk on the path of interest rate and future growth.**

As the pace of monetary policy normalization gains traction, we continue to **recommend floating rate notes and inflation linked bonds** to benefit from rising price pressures. We also keep our underweight and short duration exposure. On US equity markets, we continue to recommend exposure to cyclical sectors such as industrials, financials, technology and commodities.

**HAWKISK REVISIONS TO GROWTH, INFLATION AND UNEMPLOYMENT**

| | 2018 | 2019 | 2020 | Longer run |
|---|---|---|---|---|
| **Change in Real GDP** | **2.8%** | **2.4%** | **2.0%** | **1.8%** |
| *March projections* | *2.7%* | *2.4%* | *2.0%* | *1.8%* |
| **Headline PCE Inflation** | **2.1%** | **2.1%** | **2.1%** | **2.0%** |
| *March projections* | *1.9%* | *2.0%* | *2.1%* | *2.0%* |
| **Core PCE Inflation** | **2.0%** | **2.1%** | **2.1%** | |
| *March projections* | *1.9%* | *2.1%* | *2.1%* | |
| **Unemployment Rate** | **3.6%** | **3.5%** | **3.5%** | |
| *March projections* | *3.8%* | *3.6%* | *3.6%* | *4.5%* |

**THE FEDERAL RESERVE RAISES ITS MEDIAN DOT FOR 2018 AND 2019**




Sources: Federal Reserve, Bloomberg, Mirabaud Asset Management