

Fed raises rates, sees faster pace of increases in 2017

By Howard Schneider and Lindsay Dunsmuir

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The U.S. Federal Reserve raised interest rates by a quarter point on Wednesday and signaled a faster pace of increases in 2017 as the Trump administration takes over with promises to boost growth through tax cuts, spending and deregulation.

The rate increase, regarded as a virtual certainty by financial markets in the wake of a string of generally strong economic reports, raised the target federal funds rate 25 basis points to between 0.50 percent and 0.75 percent. Bond yields and the dollar rose after the rate decision while stocks were mixed with financials and tech the only two sectors to show gains.

“In view of realized and expected labor market conditions and inflation, the committee decided to raise the target range,” the central bank’s policy-setting committee said in its unanimous statement after a two-day meeting.

“Job gains have been solid in recent months and the unemployment rate has declined,” the Fed said, noting that market-based measures of inflation compensation had moved up “considerably.”

More significant was a fresh batch of Fed policy maker forecasts that indicated the current once-a-year pace of rate increases will accelerate next year. Markets and the Fed appeared to be close on pricing with Fed futures markets pricing in at least two and possibly three hikes, up from one to two prior to the meeting.

With President-elect Donald Trump planning a simultaneous round of tax cuts and increased spending on infrastructure, central bank policymakers shifted their outlook to one of slightly faster growth, lower unemployment and inflation just under the Fed’s 2 percent target.

The Fed’s median outlook for rates rose to three quarter-point increases in 2017 from two as of September. That would be followed by another three increases in both 2018 and 2019 before the rate levels off at a long-run “normal” 3.0 percent.

That normal level is slightly higher from three months ago, a sign that the Fed feels the economy is still gaining traction.

“They didn’t mention the fiscal stimulus but typically their aggressiveness does indicate that there’s a little more confidence that they can get away with three hikes next year,” said Aaron Kohli, interest rate strategist at BMO Capital Markets.

The Fed continued to describe that pace as “gradual,” keeping policy still slightly loose and supporting some further improvement in the job market. It sees unemployment falling to 4.5 percent next year and remaining at that level, which is considered to be close to full employment.

U.S. bond yields had already begun moving higher following the election and as expectations of the Fed rate increase solidified. By the start of this week, trading in fed funds futures assigned a greater than 95 per cent likelihood to a rate hike, according to data compiled by the CME Group.

All 120 economists in a recent Reuters poll had expected a rate hike on Wednesday.

In the weeks following Trump’s Nov. 8 victory, Fed policy makers have said his proposals could push the economy into a higher gear in the short run. Even though the details of the Republican businessman’s plans remain uncertain, Wednesday’s statement marked a rare case in the post-crisis era in

which the Fed moved its interest rate outlook higher.

Risks to the outlook remain “roughly balanced” between factors that could slow or accelerate the economy beyond what the central bank anticipates, the Fed said, no change from the November assessment.

The rate increase was the first since last December and only the second since the 2007-2009 financial crisis, when the Fed cut rates to near zero and deployed other tools such as massive bond purchases to stabilize the economy.