Federal Reserve raises interest rates, flags end of ‘accommodative’ policy

By Howard Schneider and Jason Lange
September 26, 2018 – *The Globe and Mail / Reuters*

The Federal Reserve raised interest rates on Wednesday, as expected, and forecast three more years of economic growth as the U.S. central bank left its policy for steady rate rises in place.

In a statement that marked the end of the era of “accommodative” monetary policy, Fed policymakers lifted the benchmark overnight lending rate by a quarter of a percentage point to a range of 2.00 per cent to 2.25 per cent.

The Fed still foresees another rate hike in December, three more next year, and one increase in 2020.

That would put the benchmark overnight lending rate at 3.4 per cent, roughly half a percentage point above the Fed’s estimated “neutral” rate of interest, at which rates neither stimulate nor restrict the economy.

“The thing that folks were watching for, which they went ahead and did, was remove the word ‘accommodative’ in regard to their monetary policy,” said Michael Arone, chief investment strategist at State Street Global Advisors.

“It does seem to potentially indicate they believe monetary policy is becoming less accommodative and getting more toward that neutral rate.”

That tight policy stance is projected to stay level through 2021, the time frame of the Fed’s latest economic projections.

The dollar lost ground against the euro after the release of the policy statement, the U.S. Treasury yield curve flattened and stocks rose.

The Fed sees the economy growing at a faster-than-expected 3.1 per cent this year and continuing to expand moderately for at least three more years, amid sustained low unemployment and stable inflation near its 2 per cent target.

“The labour market has continued to strengthen … economic activity has been rising at a strong rate,” the Fed said in its statement, which removed its long-standing reference to the fact that monetary policy remained “accommodative.”

It inserted no substitute language for the phrase, which had been a staple of its guidance for financial markets and households for much of the past decade. The wording had become less and less accurate since the central bank began increasing rates in late 2015 from a near-zero level, and its removal means the Fed now considers rates near neutral.

The rate hike was the third this year and the seventh in the last eight quarters. Ahead of Wednesday’s statement, traders put the chance of a rate increase at 95 per cent, according to CME Group.

Fed Chairman Jerome Powell, who took over as head of the central bank earlier this year, is scheduled to hold a news conference at 2:30 p.m. EDT (1830 GMT) to elaborate on the policy statement and the Fed’s latest two-day meeting.

New projections

The Fed’s latest projections show the economy continuing at a steady pace through 2019, with gross domestic product growth seen at 2.5 per cent next year before slowing to 2.0 per cent in 2020 and to 1.8 per cent in 2021, as the impact of the recent tax cuts and government spending fade.

Inflation was forecast to hover near 2 per cent over the next three years, while the unemployment rate is expected to fall to 3.5 per cent next year and remain there through 2020 before rising slightly in 2021.

The jobless rate is currently 3.9 per cent.

With risks described as roughly balanced, the statement left the Fed on a steady course for the next year.

Risks to the current run of economic growth, such as the threat of a damaging round of global tariffs increases, were largely set aside.

There were no dissents in the Fed’s policy statement.