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GLOBAL ECONOMIC & MARKET OUTLOOK

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FOCUS NOTES

December FOMC meeting: First hike since 2006, signaling a gradual and data-dependent pace of tightening ahead

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- As expected, the Federal Reserve raised the target range for the fed funds rate for the first time since 2006 by 25bp to 25-50bp at its 15-16 December meeting. According to the post-meeting statement, the rationale behind the committee's decision was the considerable improvement in the US labor market this year and the Fed's confidence that inflation will rise, over the medium term, to the 2.0% objective target, acknowledging the time lag with which policy actions affect future economic conditions. With respect to the pace of rate tightening ahead, the statement suggested that it will be rather gradual, dependent on the US economic outlook as well as on global financial developments. The statement also highlighted that the "stance of monetary policy remains accommodative, even after the start of the tightening process, a phrase that was also used during the 2004 tightening cycle.

- In an implementation note, that was released in addition to the FOMC statement, the Fed suspended the ceiling on the size of the reverse rate repo (RRP) at about $2trn, with the limit of $30bn per day and per counterparty. Maturing Treasury securities will keep being rolled over at auction. The governing council emphasized that the runoff of the Fed's balance sheet will probably not begin until "normalization of the federal funds rate is well under way", while previous studies by the Federal Reserve Board have concluded that balance sheet runoff would occur when the fed funds rate is between 100-200bp, i.e. sometime in the beginning of 2017.

- The FOMC published its updated Summary of Economic Projections, with the Fed's median interest rate projection for 2016 remaining unchanged at 1.375% (i.e. four hikes of 25bp each in 2016), while the said projection for 2017 and 2018 was revised slightly downwardly at 2.375% from 2.625% in September (revised down from five to four hikes of 25bp) and at 3.250% from 3.375% in September, respectively, implying a "dovish" tightening cycle with a total of eight additional interest rate hikes of 25bp until the end of 2017. The long-term target for the fed funds rates was left unchanged at 3.50%.

- As far as the US economic outlook is concerned, the Fed's estimate for US growth rate remained unchanged at 2.1% for 2015, was revised upwardly to 2.4% in 2016 (from 2.3% in September), remained stable at 2.2% for 2017 and stood at 2.0% in 2018. Regarding inflation forecasts, there was a small downward revision for 2015 and 2016, at 1.3% and 1.6% respectively, while the unemployment rate is expected to average 5.0% in 2015 and to decline to 4.7% for the subsequent three years 2016-2018.

- Looking ahead, we expect a gradual and data-dependent hiking cycle, especially in view of persistently subdued inflationary pressures and low global commodity prices. Should we witness further USD strength or continued weakness in US core PCE inflation in the coming months, then the Fed may need to follow a more dovish tightening cycle than its current projections suggest.

Table 1
Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, December 2015

	Central Tendency*				
USA	**2015**	**2016**	**2017**	**2018**	**Longer run**
Change in real GDP	**2.1**	**2.3– 2.5**	**2.0 – 2.3**	**1.8 - 2.2**	**1.8 - 2.2**
September projection	(2.0-2.3)	(2.2-2.6)	(2.0-2.4)	(1.8-2.2)	(1.8-2.2)
Unemployment rate	**5.0**	**4.6 – 4.8**	**4.6 – 4.8**	**4.6 - 5.0**	**4.8 - 5.0**
September projection	(5.0-5.1)	(4.7-4.9)	(4.7-4.9)	(4.7-5.0)	(4.9-5.2)
PCE inflation	**0.4**	**1.2 - 1.7**	**1.8 - 2.0**	**1.9- 2.0**	**2.0**
September projection	(0.3-0.5)	(1.5-1.8)	(1.8-2.0)	(2.0)	(2.0)
Core PCE inflation	**1.3**	**1.5 – 1.7**	**1.7- 2.0**	**1.9- 2.0**	
September projection	(1.3-1.4)	(1.5-1.8)	(1.8-2.0)	(1.9-2.0)	
Fed Funds Rate	**0.4**	**0.9 – 1.4**	**1.9- 3.0**	**2.9 - 3.5**	**3.3 - 3.5**
September projection	(0.1 – 0.6)	(1.1 – 2.1)	(2.1- 3.4)	(3.0 – 3.6)	(3.3 – 3.8)

*The central tendency excludes the three highest and three lower projections for each variable in each year.
Source: Federal Reserve, Eurobank Research

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