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January 2018

The January Fed meeting: a quiet end to the Yellen era

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KEY POINTS

- The Federal Reserve (Fed) maintained the current target range for the fed funds rate at 1.25% to 1.50%, as expected.
- The statement accompanying the decision acknowledged stronger U.S. growth of late and showed somewhat less concern about weak inflation.
- Market reaction was muted given the lack of policy action, but the recent rise in short-term U.S. interest rates reflects a bond market that is bracing for a more hawkish Fed in 2018.
- Chair Janet Yellen will step down as head of the Fed and its Open Market Committee following this meeting. The Senate has already confirmed current Fed Governor Jerome "Jay" Powell as her successor.
- We expect at least three 25 basis point rate increases from the Fed this year, with the potential of a fourth if inflation begins to run hotter.

WHAT HAPPENED?

After raising rates in December, the Fed took no action at its January meeting, despite stronger U.S. economic data and the enactment of individual and corporate tax cuts that are expected to boost growth. The Fed typically announces policy changes only at meetings that coincide with a press conference and a release of fresh forecasts. The next such meeting is on March 21.

The changes to the Fed's statement since December showed a committee becoming more convinced that the U.S. economy no longer requires extraordinary assistance from monetary policy to function. Specifically, the Fed inserted new language into the statement indicating that it believes "further gradual increases" in the fed funds rate will be warranted. It also noted that market-based measures of expected inflation have risen recently.

U.S. interest rates and equity prices were little-changed immediately following the release of the statement. Markets were expecting a modest upgrade to the outlook, hinting at another hike in the near future. That's just what they got.

The Fed likely views the recent uptick in longer-term interest rates and resulting steepening of the U.S. Treasury yield curve as a welcome development, as it removes a theoretical constraint for how high short-term rates can ultimately go without resulting in an inverted yield curve.

OUTLOOK

The Fed is widely expected to hike rates several times this year, starting in March. As the length of the U.S. expansion nears nine years, it is receiving fresh support from tax cuts and a surge in overseas growth. This should, for now, allow the Fed to continue raising rates even as inflation runs below its 2% target. Janet Yellen will now step down as Fed Chair, having served out her term. Her replacement, Jay Powell, is unlikely to meaningfully diverge from his predecessor's approach to monetary policy.

Expectations for 2018 rate hikes have soared since last fall

Source: Bloomberg, as of 29 Jan 2018.

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Definitions

The **Federal Open Market Committee (FOMC)** holds eight regularly scheduled meetings per year to review economic and financial conditions, determine the appropriate stance of monetary policy and assess the risks to its long-run goals of price stability and sustainable economic growth.

A **basis point** is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%

Source

Federal Reserve Statement, January 2018.

Bloomberg.

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GPE-FOMC-0118P 413165-INV-AN-01/19