FOMC: A hike and unchanged dots

- **A rate hike of 25 bps seems certain at this meeting, bringing the Fed funds rate up to 2.00–2.25%**
- **The new dot chart will most likely indicate one more hike this year, and probably three hikes in 2019**
- **The forecasts for GDP-growth, unemployment and inflation are likely to be fairly unchanged**

Assessment: As a hike seems certain at this meeting, most attention will likely be paid to the new dot chart and the press conference. We expect that the new dot chart will indicate one more hike this year, while we believe that the three hikes indicated for 2019 in June will likely remain unchanged. Even if the dot chart is not altered, the outcome could still lift market rates somewhat, as the market is still pricing in only 3–4 hikes over the coming year. Furthermore, we foresee almost no changes to the macroeconomic forecasts at this meeting.

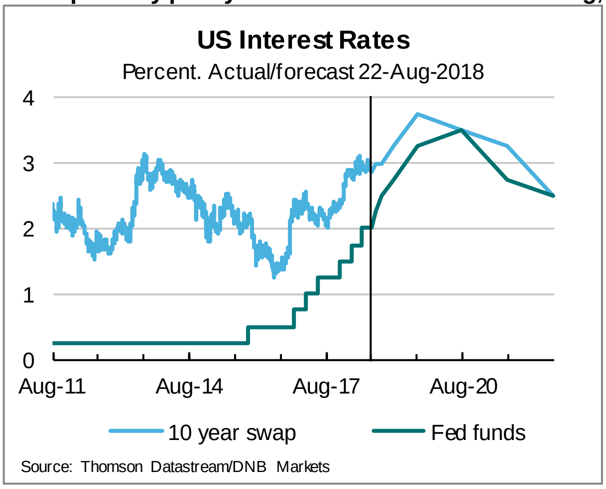
Macro data have been strong: After a weak Q1, GDP picked up in Q2 and grew by 4.2% (annualised). Our Macro score indicates that the development has been strong recently, both for the business sector and for the households. Even if the trade war vs. China is escalating, there are few macro effects to be seen so far. The labour market has also been solid, with employment growth slightly above 200k so far this year, low unemployment (3.9% in August) and slightly higher wage growth (2.9% in August). The tight labour market is likely to put further upward pressure on wages, with some spillover to inflation in the medium term. The FOMC GDP-forecast for Q4 2018 was 2.8% in June, while unemployment was expected at 3.6% in Q4. We believe the GDP-forecast will likely remain unchanged, while the unemployment forecast could be lifted somewhat. Longer term there could be some downward risk related to the GDP-forecasts due to the escalation of the trade war, even if the June-forecasts already pointed at slower growth in 2019 and 2020.

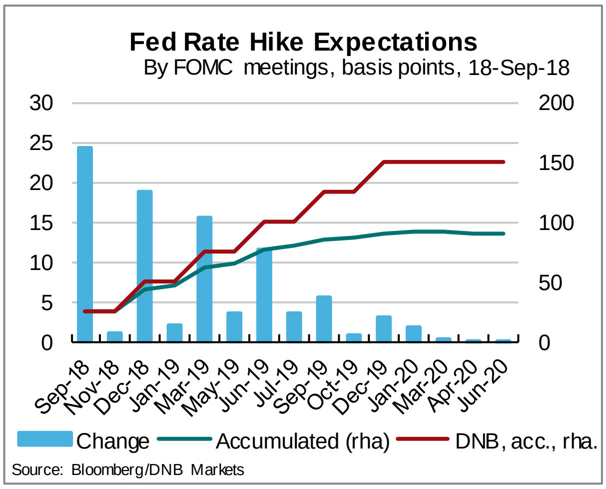
Core inflation on target: Core PCE inflation, the Fed's favourite inflation measure, rose by 2.0% YOY in July, i.e. exactly on the target. Core CPI was 2.4% YOY in July, but fell to 2.2% in August. Hence, this measure is also close to target. In June, the Fed expected core PCE inflation to be 2.0% YOY in Q4 this year. Hence, we do not expect any changes to this forecast now. However, there could be some upside risk to the forecast for 2019 and 2020 due to the higher tariffs on Chinese imports. In June these forecasts were 2.1% YOY.

Dot-chart to remain fairly unchanged: In June, the Fed's dot chart indicated two more hikes this year and three hikes in 2019. Despite a somewhat stronger macro picture now, we do not think that this forecast will be changed. Hence, we believe the dot chart will most likely point to one more hike this year (in December). Furthermore, we believe that the Fed will continue to indicate three hikes in 2019. In June, four FOMC members indicated three hikes from the 2018-median, while three others indicated four hikes, and one indicated five hikes. For the median dot to shift to four hikes (i.e. the 3.25–3.50% range), all four of those who indicated three hikes would have to lift their dots by 25 bps. We do not find this likely, even if some of them might do so. The longer run median will also likely stay at close to 3%.

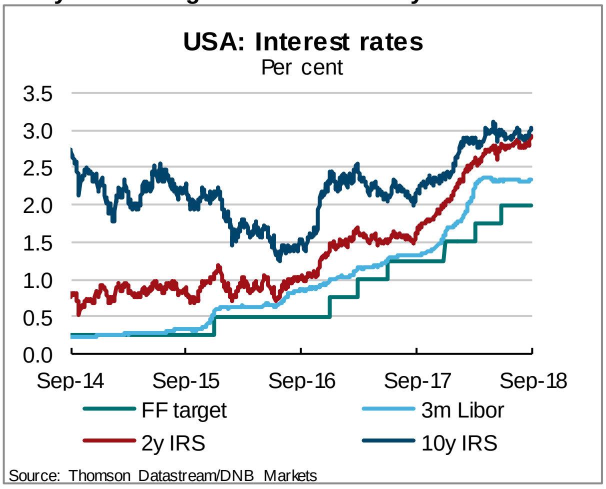
Knut A. Magnussen, DNB Markets

We expect key policy rates to be hiked at this meeting, in December and four times in 2019

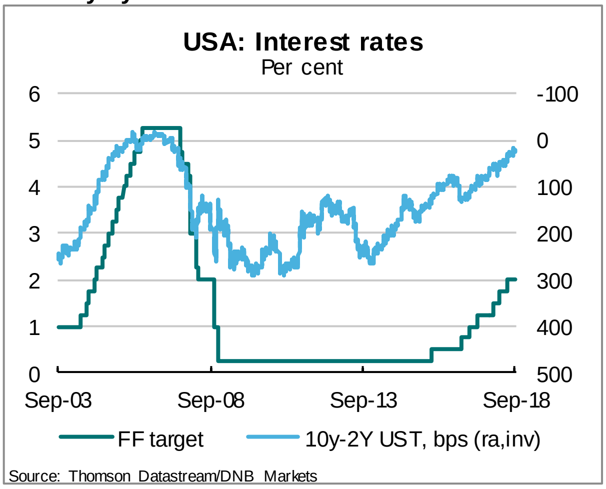




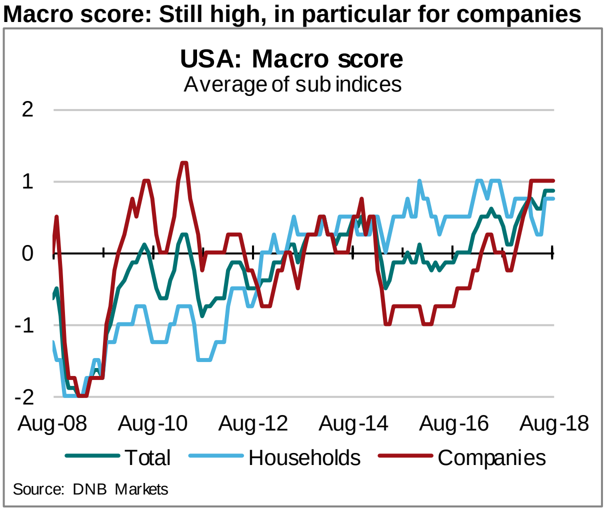
Fairly stable long-term rates recently



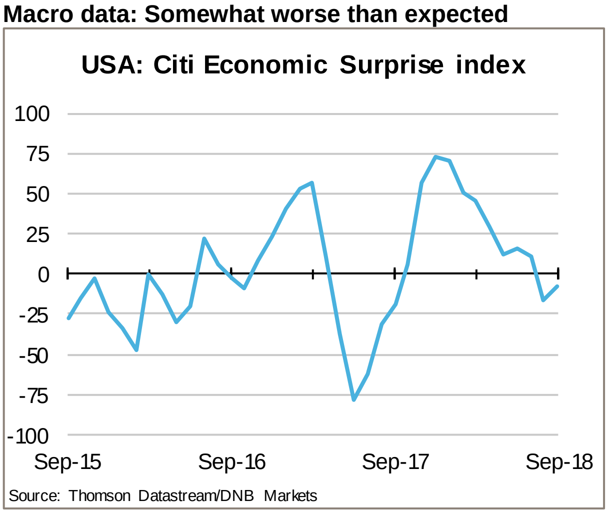
The 10y-2y curve has flattened further



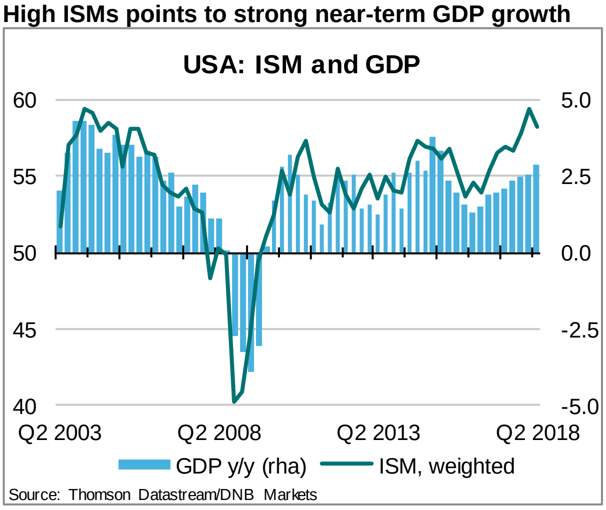
Macro score: Still high, in particular for companies



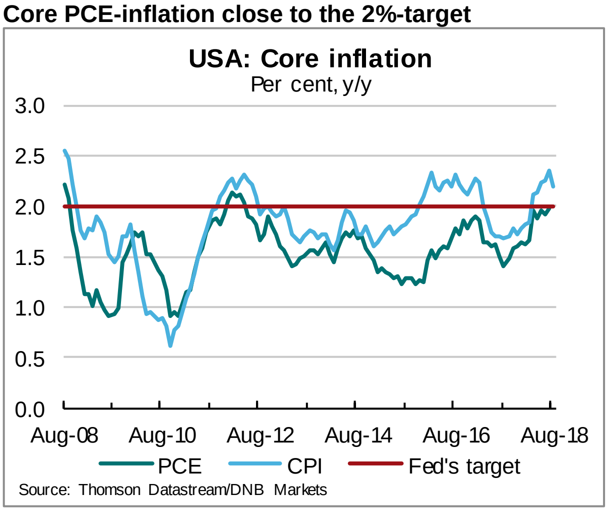
Macro data: Somewhat worse than expected



High ISMs points to strong near-term GDP growth



Core PCE-inflation close to the 2%-target



Preview: FOMC

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DNB Markets Macro Team:

Kjersti Haugland
Chief Economist, Norway
+47 24 16 90 01 / 917 23 756
kjersti.haugland@dnb.no

Jeanette Strøm Fjære
Economist, Norway and Sweden
+47 24 16 90 03 / 920 37 011
jeanette.strom.fjare@dnb.no

Ole A. Kjennerud
Economist, Euro-zone, China and Japan
+47 24 16 90 07 / +47 477 57 482
ole.kjennerud@dnb.no

Knut A. Magnussen
Senior Economist, USA and UK
+47 24 16 90 04 / 476 04 046
knut.magnussen@dnb.no

Magne Østnor
FX Strategist
+47 24 16 90 06 / 907 47 902
magne.ostnor@dnb.no

Ingvild Borgen Gjerde
FI/FX Analyst
+47 24 16 90 08 / 481 15 200
ingvild.borgen.gjerde@dnb.no

Kyrre Aamdal
Senior Economist, Norway, Sweden, Fixed Income
+47 24 16 90 02 / 906 61 112
kyrre.aamdal@dnb.no

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