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# US Macroeconomics

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## Fed Funds Could be More Restrictive than the FOMC Thinks

The Fed is going to lift interest rates another 25 basis points, bringing them to an upper band of 5.50%. More importantly, policymakers will leave the door open for at least one more rate hike, which would be consistent with the June dots plot.

Furthermore, **the FOMC statement and Chair Powell's post-meeting press conference are likely to reinforce the need for the funds rate to remain restrictive for some time**. In other words, the Fed is not going to give any hint of a policy pivot, contrary to bond market expectations.

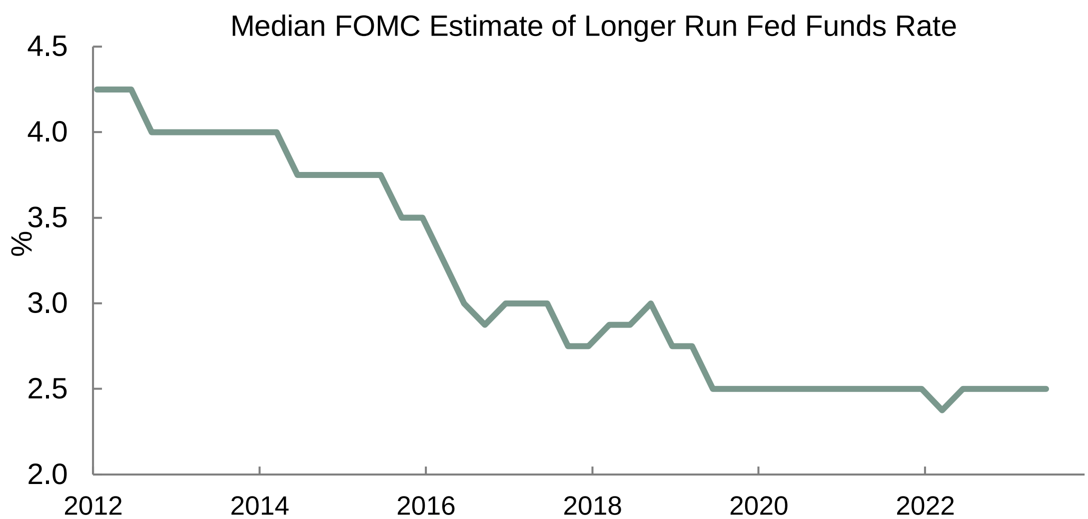
Where monetary policy goes will be dependent upon the evolution of the macroeconomic outlook, which is highly uncertain, perhaps more so than in the recent past. These crosscurrents are evident in financial markets.

For example, the Treasury yield curve remains deeply inverted as stocks approach their previous highs. And credit spreads are historically tight as bankruptcies and defaults are on the rise. Another rate hike combined with the intention to keep fed funds in restrictive territory runs the risk of a deeper downturn, whenever the next one comes.

In the chart below, we show the running median FOMC estimate of the longer run projected fed funds rate. Essentially, this is the Fed's consensus estimate of the nominal equilibrium interest rate or 'R-Star.' As we can see, there is significant uncertainty around its value.

**Since January 2012 when the FOMC first began publishing the dots plot, R-Star has come down sharply from 4.25% to 2.50% at present**. But notice that policymakers had raised their collective estimate of R-Star in 2018 only to lower it the following year when economic and financial duress led to interest rate cuts. R-Star is a moving target, and its value is highly uncertain.

Based on deteriorating productivity, worsening demographics, and elevated debt, R-Star may be even lower than current estimates. With the funds rate finally getting closer to an eventual peak, monetary policymakers would be wise to be less hawkish and more agnostic about what comes next. We fear, however, this is unlikely to be the case. Stay tuned.




Sources: FRB, Bloomberg, Haver, SMBC Nikko

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