A Quick Take on Yellen's Swan Song

Post-Fed Reaction **Dec. 13, 2017**

In Federal Reserve Chair Janet Yellen's last press conference, she discussed the Fed's decision to raise its benchmark interest rate by 0.25%. Our fixed-income experts share their views on the move as well as recent economic expansion, monetary policy, inflation and their implications for bond investors.

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On Wednesday, the Fed raised the target range on short-term interest rates to 1.25% to 1.5%, marking its third rate hike in the past year. Seven FOMC members voted in favor of the move while two FOMC members—Neel Kashkari and Charles Evans— voted against the action, due to ongoing concerns about below-target inflation.

While the rate hike wasn't a surprise, it comes on the same day that inflation data disappointed with a 0.1% rise in the consumer price index. We believe that inflation will be the leading indicator to watch in 2018, serving as a guide to whether or not the Fed continues to raise rates. The market reaction was muted.

Through its forecasts, the FOMC is signaling three 0.25% rate hikes in 2018. With the unemployment rate at 4%—below what is considered full employment—and inflation under control, we wonder why the FOMC was so firm its desire to raise rates. Perhaps the Fed's unofficial mandate of financial stability is in the back of central bankers' minds.

With the stock market reaching new all-time highs with each passing day and corporate credit spreads extremely tight, favorable financial conditions are likely playing a role. Further, fiscal stimulus in the form of tax reform—currently being debated in Congress—was also a consideration, Yellen said during her press conference. Some FOMC members have factored tax reform into their economic projections while other members have taken a "wait-and-see" approach, she noted.

The Fed's economic projections or "dots" were relatively unchanged with three interest-rate hikes expected in 2018. Its forecast for core PCE, the Fed's preferred measure of inflation, was unchanged at 1.9%. However, economic growth projections were raised to 2.5% from 2.1%. On the jobs front, the Fed forecast for the unemployment rate dropped to 3.9% from 4.1%.

The bond market actually rallied on the day with the yield curve continuing to flatten. Specifically, AAA municipal bond yields were down. The stock market closed out the session at a record high.

For more on what rising rates and a new Fed chairman mean for bond investors, **read How to Play a Powell-Led Fed**, an interview with Leo Dierckman and Michael Richman.

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