Chart of the Month

September 2018

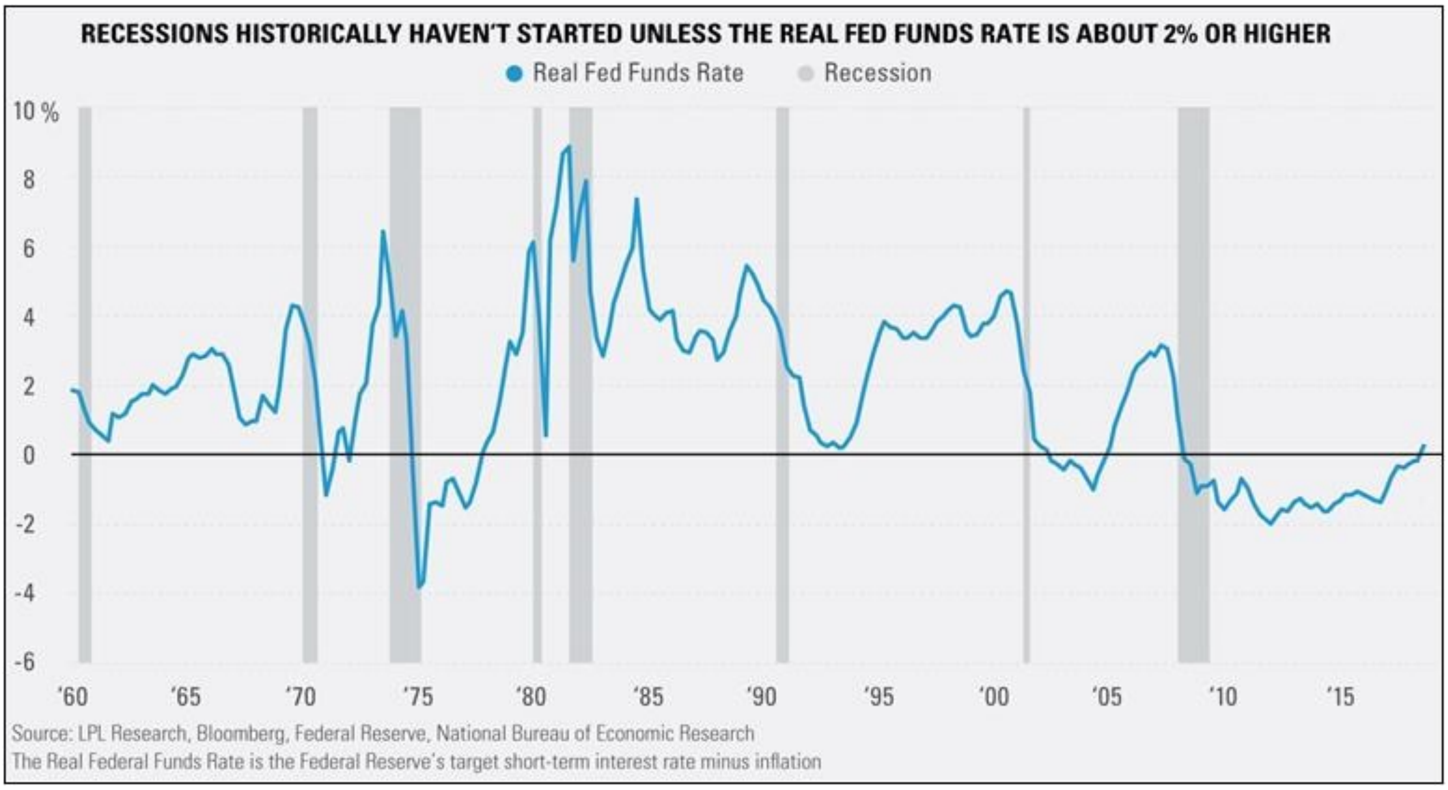
The Federal Reserve, as expected, raised interest rates yesterday for the third time this year and signaled a fourth hike in December. The target range for the fed funds rate is now 2.00%-2.25% and will likely jump to 2.25%-2.50% in less than three months. Furthermore, the central bank anticipates that it will increase the benchmark rate at least twice to 2.75%-3.00% and as many as four times to 3.25%-3.50% in 2019.

As shown in the chart below, the *real* federal funds rate is currently sitting at or just above zero (2.00%-2.25% less 2% inflation). This rate has been an important barometer in dictating the timing of recessions. In fact, the real fed funds rate was 2% or higher ahead of each of the past eight recessions since 1960.

Based on this indicator, the real fed funds rate would need to rise by at least two percentage points before the onset of the next recession. If inflation remains at its current level, the Fed would have to hike its key rate seven more times to put the real fed funds rate at the low-end of the range that has historically preceded recessions. Therefore, unless the Fed becomes much more aggressive than planned in boosting rates, a recession is unlikely to occur until mid-2020 at the earliest, suggesting that the business cycle has plenty of room to run.

In the meantime, the Fed described the economy as “strong” and increased its GDP estimate for 2018 from 2.8% to 3.1%. If achieved, that will be the highest annual GDP rate in 14 years. The Fed also bumped up its growth projection for 2019.

The bottom line is that the economy is performing extraordinarily well and corporate profits are soaring to record highs. While the growth rates may slow next year and beyond, business conditions have strengthened over the past several quarters and should remain in an expansionary mode for at least the next couple of years.



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