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After the Fed's Rate Hike: 5 Economists Predict What Comes Next

How the Federal Reserve will adjust interest rates in 2017 is far from clear, and it depends heavily on the success of President-elect Donald Trump's stimulus package.

By Tim Mullaney

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Everyone knows the **Federal Reserve** is likely to raise short-term interest rates tomorrow, for only the second time since the 2008 financial crisis.

Futures prices put the odds of a hike at 97%, with the U.S. economy at or near full employment and gathering steam, and Capitol Hill Republicans gearing up to help President-elect Donald Trump with a stimulus plan that may yield further gains.

What happens next is far less clear: The shape and impact of Trump's stimulus remain to be seen, along with the effects of new trade policies and global developments such as Britain's departure from the European Union. That leaves traders grappling with the question of whether incentives will help companies like retailer **Wal-Mart** and automaker**General Motors** more than trade crackdowns might hurt exporters like **Boeing** ?

To provide some insight, we asked leading economists what to look for from the Fed's statement on Wednesday and Chair Janet Yellen's news conference. Here are some of the highlights, edited lightly for clarity.

Ethan Harris, Chief Global Economist, Bank of America Merrill Lynch:

You're looking for how much optimism will they express. The Fed keeps saying the glass is half-empty. You're looking for little nuances, but I don't think the Fed has any big message. Like other economists, they're trying to figure out what 2017 will bring.

[Harris went on to say the Fed may raise rates only once in 2017, and later than June, when the market expects the first of two hikes next year, because inflation remains below the central bank's 2% target rate. It may act sooner if the new president's stimulus is on track by then.]

The data are quite compelling...I wouldn't be that thrilled if I were Yellen that fiscal stimulus is coming...The Fed is quietly overshooting its own inflation target. A little inflation is good right now. They're acting as if 2% is not a ceiling, as if 2% is an average.

Bernard Baumohl, Chief Economist, Economic Outlook Group, Princeton, N.J. and visiting professor at Florida Gulf Coast University:
The Fed is fully justified in raising rates. I think they'll play it very cautious with the rest of the statement. They're not going to give any clue [of how fast rates will rise]. That's largely because they just do not know the what kind of fiscal policy will emerge from the new administration and how much of it will be enacted. It's difficult to know how much the tax cuts will affect the economy. While Trump has been very aggressive in his proposals, we know it won't sit well with conservatives in Congress. We may see something much more diluted. ... He represents to me the mother of all uncertainties."

Mark Zandi, chief economist, Moody's Analytics , West Chester, Pa.:
The election is likely a game changer for the Fed, at least financial markets think so. Investor expectations are high that with President Trump, the economy will get big tax cuts and government spending increases resulting in bigger budget deficits. In other words, the economy will get fiscal stimulus. Stimulus applied to an economy that is at full-employment will fuel stronger inflation, and the need for higher interest rates sooner. Hopefully the meeting sheds light on whether Fed policymakers are thinking the same way as markets.

Richard Moody, Chief Economist, Regions Financial Corp. , Birmingham, Ala.:
They will release the latest round of projections but I don't expect their growth outlook to change materially. Nor do I expect the trajectory of the funds rate implied by the dot plot [a chart compiled by the Fed on the possible future path of interest rates] to change much -- I think it will still imply two hikes next year.
They are doing exactly what the rest of us are doing -- trying to assess the impact of potentially significant changes to fiscal, regulatory, and trade policy in 2017. And, if you've listened to their public comments over the past week, they've all indicated that, given the absence of specific policy changes, they have no grounds to change their outlook at this point, but they clearly will be interested in how much fiscal expansion we may get and what that might mean for inflation and the U.S. dollar. Given the uncertainty stemming from policy, I expect them to stress their "data dependent" mantra, and I expect Dr. Yellen to stress this point in her press conference.

Dean Maki, Chief Economist, Point72 Asset Management, Stamford, Conn.:
The important issue will be what guidance the Fed gives regarding future rate hikes. Do the dots move? They currently have two hikes in 2017, and three in 2018 and 2019. Also, what does Chair Yellen say about the criteria for the next hike? Does she need to see further improvement in the labor market, actual [increases in] inflation, or what? Market participants will be looking for whether she seems to be guiding toward a new hike in June (which would be consistent with the Fed's forecast) or if she seems to be skewing her comments either way from that expectation. Fiscal policy plans will not change the Fed's trajectory until they are passed into law. The Fed feels it has time to monitor the legislation, as they are not fearing that inflation will get out of hand anytime soon. Given the lags between when policy is passed and when fiscal stimulus actually affects the economy, they feel they will have time to adjust as necessary.

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