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What might the U.S. inflation picture look like in 2019? How do you think the Fed will respond?

The inflation data have generally been subdued, hovering right around 2% on a year-over-year basis for underlying inflation. Generally speaking, the story should be supportive for inflation in an environment where the unemployment rate is quite low. Wage inflation is moving higher in excess of 3% and, generally speaking, that should push into underlying price inflation.

However, that mechanism isn't quite working in this environment. That's probably in part due to technological changes which are disinflationary... global forces, which are also disinflationary. So we think that in general what we'll end up seeing is underlying inflation gradually head higher but by no means should we be assuming that we're going to see a big move up in inflation for 2019. An inflation forecast of just above 2% seems reasonable for the year.

So what does the Fed do in this environment with inflation remaining pretty subdued? I think it allows the Fed to proceed with a very gradual hiking cycle. The Fed has so far brought interest rates modestly higher over the past few years but in a very transparent and cautious matter. And I think that that approach will continue into 2019 and the Fed is going to be largely data dependent in this environment. It will be a function of how inflation proceeds. It will be a function of how the labor market evolves as well. But generally speaking it will likely be a gradual move up in interest rates as the Fed calibrates to the broader economy.

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