Fed preview: Take it easy...

After three consecutive rate cuts Federal Reserve officials believe they have done enough to stabilise the economy. With the Fed firmly "on hold" this week the focus will be the press conference and "dot plot" for guidance for 2020

Source: Shutterstock

A job well done...

Looking back at what has happened over the past four months you would have to say policymakers have done a great job at calming what at one point was a pretty febrile environment.

In August equities were selling off, the yield curve was inverted - historically a strong predictor of recession - and activity data was starting to soften. Since then we have had hints of a US-China trade deal, but we have also had three interest rate cuts from the Federal Reserve totalling 75 basis points. Equities are up more than 10% back to new all-time highs, the yield curve has re-steepened while a better balance to the macro data has provided greater optimism that a recession will be avoided.

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After the rate cuts in July, September and October, Federal Reserve officials have indicated a preference to pause. The minutes from the 30 October Fed meeting stated that "participants generally viewed the economic outlook as positive" and while there was a majority to cut interest rates at that meeting, "a couple" of members who voted for the 25bp cut thought it was a "close call" decision.

Individual Fed speakers have reinforced the message that there needs to be a "material" change in the economic outlook for them to implement further rate cuts. Friday's remarkably strong jobs report confirms that this week's decision will result in a "no change" outcome with the press conference emphasising the data dependency for future decision making.

Going dotty

We will also get an update of the Fed's forecast versus those published in September and a new "dot plot" on predicted path of interest rates. In terms of their macro forecasts, we are only likely to see near-term revisions lower to the unemployment rate projection given the latest officials data.

They will also have to lower their 2019 forecast for the Fed funds rate given they didn't predict their own October rate cut in September. Currently, they are suggesting the next move is a rate hike in 2021 and we suspect this will remain the case.

Federal Reserve economic projections with ING expectations

	2019	2020	2021	2022	Longer run
Change in real GDP (Sep Fed forecast)	2.2	2.0	1.9	1.8	1.9
ING expected Fed Dec projection	**2.2**	**2.0**	**1.9**	**1.8**	**1.9**
Unemployment rate (Sep Fed forecast)	3.7	3.7	3.8	3.9	4.2
ING expected Fed Dec projection	**3.5**	**3.5**	**3.7**	**3.9**	**4.2**
Core PCE inflation (Sep Fed forecast)	1.8	1.9	2.0	2.0	-
ING expected Fed Dec projection	**1.8**	**1.9**	**2.0**	**2.0**	**-**
Federal funds rate (Sep Fed forecast)	1.9	1.9	2.1	2.4	2.5
ING expected Fed Dec projection	**1.7**	**1.7**	**2.1**	**2.4**	**2.5**

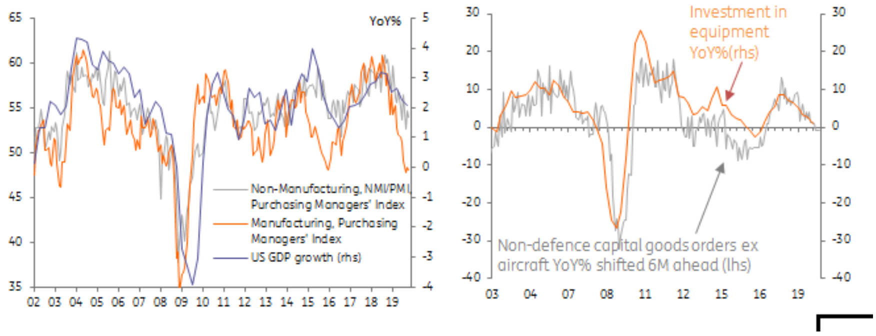
Source: Federal Reserve, ING

It's not all just about payrolls...

Like the market, we continue to see the risks skewed towards more rate cuts before an eventual hike. While Friday's jobs numbers were fantastic other data suggest that the US economy is slowing. Capital expenditure has contracted in both 2Q and 3Q19 with the durable goods report hinting at a likely third consecutive fall in 4Q19.

The latest ISM business surveys softened again while the external environment remains weak with German industrial numbers and Asian trade data reinforcing this message. Given this situation, we suggest that renewed slowing in job creation is the most likely path ahead through 1H20.

Business surveys continue to soften



Source: Macrobond, ING

Trade will continue to weigh on activity

Trade tensions also remain a key issue. It may well have been that optimism after President Trump announced a phase 1 deal with China concerning agriculture products gave a lift to sentiment and activity. However, the fact we are now two months on and there has been no signed deal underline the message that trade remains a very challenging area.

President Trump has suggested he is prepared to wait until after next year's election to conclude a deal while White House economic advisor Larry Kudlow stated that "if the agreement isn't complete, our current law will restore tariffs", implying that another wave of 15% tariffs on $156 billion of consumer goods from China could go ahead as scheduled on 15 December. It is possible that this gets delayed, but the uncertainty that this all generates leaves us to conclude that trade will remain a major headwind for growth in 2020 by disrupting supply chains, hurting profitability and damaging sentiment.

Our 2020 Fed view

Given ongoing trade uncertainty, weak external demand and the strong dollar we are comfortable to be on the softer side of market expectations for GDP growth (1.4% versus 1.8% for 2020 GDP) and bond yields (targeting 1.4% in 1H20). Political uncertainty surrounding next year's election could also see businesses taking a more cautious approach on expansion plans, with an emphasis on "wait and see".

With inflation looking benign the Fed has the flexibility to respond and so we continue to see the potential for two 25bp rate cuts in 1H20.

Author

James Knightley
Chief International Economist
james.knightley@ing.com

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