

Federal Reserve: Keeping the balance

While financial markets continue to price in rate cuts, the Federal Reserve is maintaining a cautiously upbeat tone that to us signals stable monetary policy through 2019



Source: Federal Reserve

There were no real surprises from the Federal Reserve with the target range for the federal funds rate left at 2.25-2.5%. The vote was unanimous with the press release again emphasizing the FOMC's willingness to be "patient" on policymaking despite President Trump's ongoing demands for an immediate rate cut.

The general tone was upbeat and it certainly didn't signal an inclination to cut policy interest rates anytime soon. Both the growth and the rate of jobs growth is described as "solid" – which is a slight upgrade on the March FOMC statement when they commented that the economy had "slowed from its solid rate". The Fed acknowledged that inflation is running below target, but mitigated this by stating inflation expectations "are little changed".

The Fed did announce a technical change to the interest rate paid on required and excess reserve balances, lowering it by 5 basis points to 2.35%. This is characterised as a way of helping to keep the effective fed funds rate within the target range since it has been pushing up towards the ceiling due to the Fed's balance sheet changes. It should not be construed in any way as a form of policy easing.

For now, though the market is of the mindset that inflation will remain low, growth will slow and

the Fed will need to respond by cutting interest rates later this year.

In terms of our view on the outlook for monetary policy, GDP growth will certainly slow with an inventory run down and a rebound in imports acting as a drag over the next couple of quarters. However, a robust jobs market and firm confidence readings can help partially offset the fading support from the fiscal stimulus. Improving financial conditions – lower borrowing costs, rising equities, a stable dollar – should also support growth. We still expect the economy to expand 2.5% this year.

As for inflation, we think the market is being a little too relaxed regarding the prospect of a pick-up. Rising labour costs in the form of both wages and other benefits could be passed onto consumers while higher energy price will feed through into other components. Gasoline prices have jumped 30% from \$2.23/gallon in mid-January to \$2.88 today and this will soon start to be felt in transport fares and distribution costs.

Given the decent growth story, the improvement in financial conditions and the prospect of rising inflation we see little reason for the Federal Reserve to cut interest rates.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.