

Article | 30 April 2018

UNITED STATES

Federal Reserve preview: Take a deep breath

The Federal Reserve will leave monetary policy unchanged this week but its finger remains on the trigger



Source: Shutterstock

3

Number of additional Federal Reserve rate hikes we expect this year

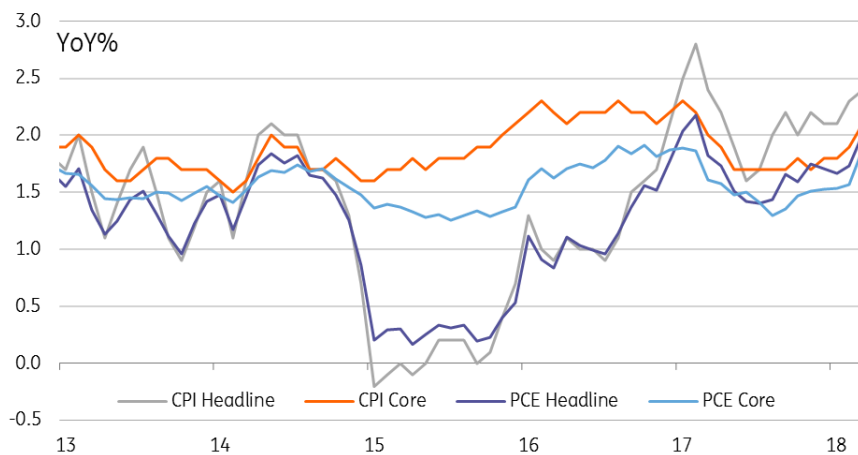
Growth & gradualism

Having raised interest rates only last month the Federal Reserve will pause for breath this week; consistent with its policy stance of “gradual increases”. Nonetheless, the case for tighter monetary policy remains strong with the recent data flow likely to give the Fed the confidence to raise rates another three times this year.

1Q GDP growth was softer relative to previous quarters, as is usually the case despite extensive seasonal adjustments. On this occasion we attribute it primarily to bad weather and equity market volatility/protectionist trade rhetoric unsettling sentiment and spending. However, the

prospects for 2Q activity look good with consumer confidence and business surveys having rebounded. The combination of rising wages and employment together with huge tax cuts means the domestic demand story looks robust while the softer dollar gives US exporters a competitive edge to benefit from stronger global demand.

Inflation no impediment to rate hikes - all are at or close to 2% Fed target



Source: Macrobond

Inflation pressures are building

At the same time, inflation readings continue to firm with both headline and core CPI above the Fed's 2% year-on-year target while the headline and core personal consumer expenditure deflators will almost certainly join them next month. Add in the tight jobs market, which resulted in last Friday's Employment Cost Index showing wages and salaries rising at their fastest rate since 3Q 2008 and the case for ongoing "gradual" rate hikes remains strong.

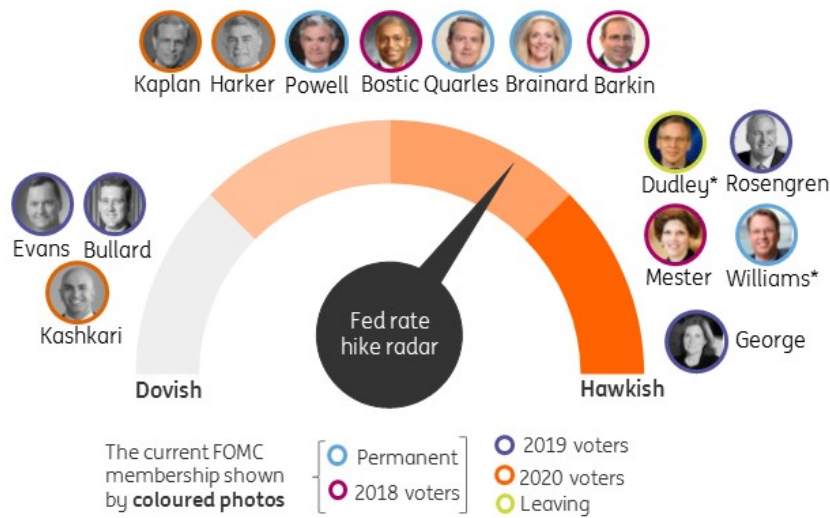
Interestingly, there has been a growing hawkishness to much of the commentary from Federal Reserve officials. Even arch-dove, Minneapolis Fed President Neel Kashkari, who had been arguing for no further rate hikes, has swung behind the Fed's own projected path of two to three more rate rises this year. As such, the accompanying statement is likely to retain an upbeat bias and we continue to see the balance of risks skewed towards a more aggressive Fed response to combat fears of economic overheating.

Trump's trade tensions remain the risk


Trade protectionism remains the main threat to our view. Treasury Secretary Steven Mnuchin is in China this week for preliminary talks to try and get a deal that will make trade between the nations "fairer" in the minds of the US administration. This will be a tough ask and at this early stage is unlikely to deliver anything significant.

THINK economic and financial analysis

Relations with Europe could also become increasingly strained despite recent meetings with Emmanuel Macron of France and Angela Merkel of Germany. Exemptions on steel and aluminium tariffs for EU nations will expire on Tuesday (1 May) and while Commerce Secretary Wilbur Ross has suggested some nations could be spared the tariffs, not all will. As such, Europe's response will have to be carefully crafted – do too little and their own credibility will be hurt with their domestic electorates. Do too much and it could quickly escalate into a hugely damaging all-out trade war that will almost certainly make the Fed think again on rate hikes.




Neutral
 "The FOMC's patient approach has paid dividends and contributed to the strong economy we have today"




Jerome Powell, Fed Chair

Hawkish
 "I expect that we'll see inflation reach and actually slightly exceed our longer-run 2 percent goal for the next few years"




John Williams, San Francisco Fed

Neutral
 "I'm not viewing the current flattening of the yield curve as a particular signal of recession"




Randall Quarles, Federal Reserve Board

Hawkish
 "The recently enacted fiscal stimulus should boost the economy at a time when it is close to full employment and growing above trend"




Lael Brainard, Federal Reserve Board

Neutral
 "Given the economy's strength, we don't want to get behind the curve, but we also don't want to overreact to the positive outlook and potentially curtail the expansion"



Loretta Mester, Cleveland Fed

Hawkish
 "With upside risks to GDP growth and employment, I do believe the risk to the inflation outlook is also to the upside"



Raphael Bostic, Atlanta Fed

*NY Fed Chair Dudley is to leave the committee after May's meeting. Current SF Fed Chair Williams is set to take over.

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.