

US: Fed sticks to its guns

The Fed left monetary policy unchanged and has little inclination to shift its position in the near-term. Nonetheless, growth risks remain skewed to the downside with a rate cut remaining our call for 2020



Source: Shutterstock

Steady as she goes...

The Federal Reserve has voted unanimously to leave the fed funds target rate unchanged at 1.5-1.75%. Given the solid if unspectacular growth backdrop, benign inflation readings and firm asset prices this was the only realistic outcome.

In terms of the statement itself there was just one minor tweak. Household spending, which had been described as rising at "a strong pace" in December has been downgraded to "rising at a moderate pace". Despite this, the statement reiterates that in the Fed's view, policy is "appropriate" to support sustained economic expansion and keep inflation in line with the 2% goal.

The annual rotation of voting members also didn't deliver any surprises. The dovish leaning James Bullard and Charles Evans and the hawkish Esther George and Eric Rosengren have been replaced by the more cautiously hawkish Loretta Mester and Patrick Harker, the fairly neutral Robert Kaplan and leading dove, Neel Kashkari, but none broke from the center ground on this occasion.

It should be noted that the Fed did raise the interest rate paid on required and excess reserves by

5bp to 1.6%, but this is purely a technical issue and doesn't have a direct read-through for the monetary policy stance. As the Fed says in a supplementary notice, this is "intended to foster trading in the federal funds market at rates well within the FOMC's target range". The Fed will also continue its repo operations at least through April – a policy that was implemented to provide some calm after September's dislocation in overnight funding markets that resulted in a spike in borrowing costs. Again this is technical and not a signal for future potential policy shifts.

The Fed is happy to hold...

After a market/data wobble in late summer, officials feel that the three 25bp rate cuts implemented in the second half of last year, coupled with the phase one trade deal between the US and China, have stabilized the situation. Only a “material change” in the outlook is going to make them alter their assessment that policy is on hold for the foreseeable future.

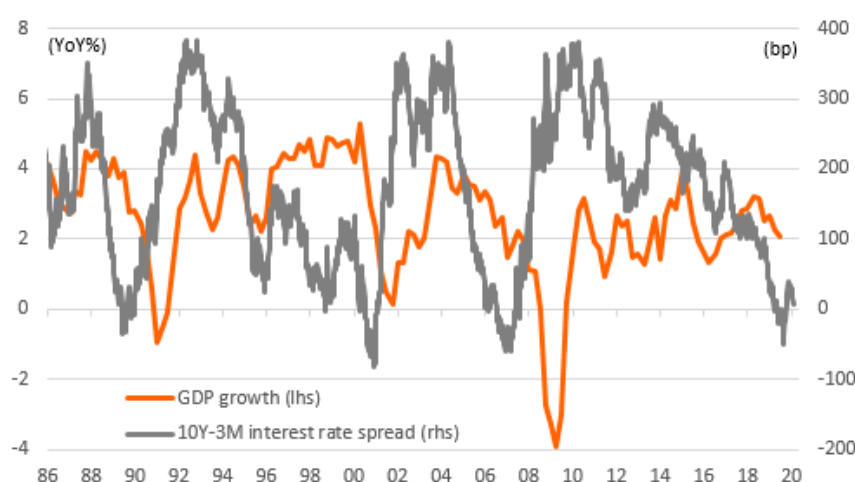
Their “dot plot” of individual member forecast from December signals that the most likely next course of action is a rate hike, but not until early 2021. This ties directly in with the Fed's notorious caution about implementing policy changes close to Presidential elections.

We, however, continue to see the balance of risks favouring a rate cut before the summer is out – a view that has gained greater credence given worries about the potential global economic costs of the coronavirus outbreak.

... but the balance of risks points to lower rates

We were already sub-consensus on US growth, seeing little upside for investment spending given cautious corporate boardrooms and the uncertainty generated by the Presidential election. Strong consumer sentiment is unlikely to translate into any significant pick-up in spending given the slowdown in wage and income growth. Then there is the Boeing situation and the cessation of 737-Max production, which could have significant knock on effects for economic activity.

Yield curve inversion highlights market fears for growth



Source: Macrobond, ING

The threat that the coronavirus outbreak poses in an environment of already subdued global

growth underlines the potential for medium-term US economic weakness. So far, the market and economic impact appears limited with the travel and airline industries the most impacted. Nonetheless, the US yield curve, which is flirting with inversion once again, highlights broader market fears that the virus and its human and economic threat could spread. The more that it does the more likely it starts to alter consumer and corporate behavior, thereby prompting policy action to mitigate the dangers.

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 <http://www.ing.com>.