

US: Prolonging the pause...

Fed Chair Jerome Powell has repeated comments that economic 'cross-currents' require a 'patient' approach to monetary policy. But unlike the market, we believe the risks remain skewed to higher interest rates eventually



Fed Chair, Jerome Powell

Source: Shutterstock

Prolonging the pause?

The Federal Reserve chair Jerome Powell's monetary policy testimony to the Senate Banking Committee sees him emphasise the commitment to a more 'patient', 'data dependent' approach to monetary policy that the Fed has adopted since the January FOMC meeting.

Today's narrative suggests the Fed will be in no hurry to adjust its neutral policy stance, indicating that we could be in for a prolonged period of policy stability

By way of justification, he argued that "in the last couple of months, some data has softened". Certainly, the latest retail sales numbers were poor and mean that 4Q GDP growth may have

slipped below 2% - we get that data release on Thursday. As for the outlook, Powell repeated comments from last month that “we have seen some crosscurrents and conflicting signals”. In this regard, he cites financial market volatility and tighter financial conditions together with weaker growth, particularly in Europe and China.

Given these risks and 'muted' inflation pressures, Jerome Powell reiterated that the Fed has adopted a 'patient' approach with monetary policy being 'data dependent'. Today's narrative suggests the Fed will be in no hurry to adjust its neutral policy stance, indicating that we could be in for a prolonged period of policy stability.

But there are positives...

However, Powell does offer some positives, admitting that the economic drag from the government shutdown is “expected to be fairly modest and to largely unwind over the next several months”. Moreover, the jobs market remains a clear positive with “ample availability of job opportunities” boosting labour force participation and wages. Overall, economic conditions are regarded as 'healthy', and the outlook is 'favourable'.

Chair Powell also addressed the size of the Fed's balance sheet following hints in the minutes to the January FOMC meeting that it could conclude the shrinking process earlier than initially thought. They are in the process of evaluating what they should do, dependent on economic and financial developments, but underlined that “in the longer run, the size of the balance sheet will be determined by the demand for Federal Reserve liabilities such as currency and bank reserves.”

Which way will they go?

In terms of the outlook for interest rates, markets believe that the Fed's neutral stance will eventually give way to policy easing. Fed funds futures contracts are pricing in a 25bp rate cut by the summer of 2021, but we continue to believe that the next move is more likely to be an interest rate increase. After all, the economy is running pretty strongly with little spare capacity, and this is generating rising wage pressures in the labour market, which should keep consumer confidence and spending supported.

Fed funds futures contracts are pricing in a 25bp rate cut by the summer of 2021, but we continue to believe that the next move is more likely to be an interest rate increase

If positive sentiment on US-China trade relations can be turned into something more concrete, this can be a real boon for the global economy. It can lift business confidence and encourage more investment spending in the US economy at a time when supply constraints are increasingly materialising.

Broader inflation pressures are set to build too with gasoline prices now responding to higher oil prices while the pick-up in worker pay and benefits is likely to nudge consumer price inflation upwards too.

This is admittedly a glass half full narrative. But if we do get decent economic performance

as we expect, in an environment of rising inflation pressures and decreasing trade concerns, we believe the Federal Reserve will overcome its current reticence and hike rates 25bp during the summer.

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.