

## Fed hikes - puts a glossy spin on the economy

25bp hike was expected - but there are some worrying aspects of this meeting...ECB next



Source: Federal Reserve

### "Bob, I got a bad feeling on this one, alright? I mean I got a bad feeling!"

No prizes for googling the quote above from Oliver Stone's 1986 film, "Platoon", but this was what popped into my head immediately on waking up in the middle of the night and unable to fall asleep, sneaking a look at my phone to see what the Fed decision had been (I'm a 12-hour time zone away). For the house view, [please see the note](#) by my Developed Market colleagues.

More often than not, when your subconscious tells you something, it's a good idea to listen.

So how does my conscious-self rationalise this vague sense of foreboding this morning? This isn't going to be easy, because if it was so obvious, my conscious-self should already have figured it out.

The main thing that I think is nagging at my sub-cortex is the speeding up of rate hikes in 2019. The median FOMC view is now that this rises to 3.1% (so 3-3.25% in practical terms), above what the longer run projections of 2.9% (so 2.75% to 3.0%) that might be viewed as the equilibrium rate.

The slight overshoot of the longer-run value is not new. What is new is that this now happens earlier (in March this was not until 2020), and following four hikes (not three or four) in total in 2018.

In short, Powell has picked up the pace. To examine why, let's start with one of Powell's quotes from last night. The US economy is "...in great shape". That is a pretty unambiguous start.

But he follows this up with confusion over the lack of wages growth, despite the fact that "...The main takeaway is that the economy is doing very well. Most people who want to find jobs are finding them, and unemployment and inflation are low," This was, he said, a "puzzle".

Well, yes, it is different to how the economy normally evolved in previous business cycles. But maybe the old relationships on which Fed policy was based have changed, even if they still work after a fashion. Have you considered that Mr Chairman? At that point, the unemployment/wage-inflation trade-off that the Fed used to underpin all of its decisions with, may no longer give you right answers.

When I'm not sure what signals I am getting, like navigating through my apartment in the dark to avoid waking the members of my family that don't have to get up at 5:45am each morning, I tend to go slowly to avoid colliding with doors, furniture etc. Powell's approach to uncertainty seems to be to speed up.

Powell was equally dismissive of the impact of the brewing global trade war on the US economy. "Right now, we don't see that in the numbers at all. The economy is very strong, the labour market is strong, growth is strong. We really don't see it in the numbers. It's just not there". Although he then conceded that the Fed had heard of firms postponing investment exactly because of such fears. Hmmm.....is it there, after all, Mr Powell?

There are of course plenty of other aspects of the meeting we could fixate on - the decision to provide a press briefing after every meeting (it's not just me, this got a collective groan at the morning meeting today - central banks have no better idea than most of us what is going on in the economy, why do we need more of this?), or the technicalities of the interest rate on excess reserves, which was only raised 20bp to push the effective Fed funds rate back towards the middle of its range.

But in the end, I guess this all boils down to a barely concealed complacency that I find worrying in the face of so many domestic (Ben Bernanke's prescient Wile. E Coyote comments) and international (Trade war) uncertainties.

2.9%

Fed's long run rate expectation

3.1% - where they expect to be at the end of 2019 (not 2020)

## ECB next - not complacent enough?

One thing you can't criticize the ECB about is complacency, indeed, they could do with being a little less cautious. But we anticipate some movement towards a taper of QE at today's meeting.

Things to watch out for:

1. Did the governing council discuss the taper?
2. If so, did they reach a decision on when this will start (September?)
3. And if so, did they come up with a decision on when it will end?

Markets will be disappointed if, after Peter Praet's comments recently, the answer to 1) is "No". And they will be rightly disappointed if the answer to 1) is "Yes" but 2) is "No", though this would be in keeping with the glacial pace at which most ECB decisions are taken. Whether this is September, though it another matter. Surely enough information has been obtained to enable the ECB to determine if the economy still warrants emergency QE support. To me, the answer is an unequivocal "Yes" it has. If so, why even wait until September? Start next month. As for when it ends though, there is more room for discretion. Date dependent policies (like the Fed dot projection - why have they not ditched that?) are less defensible than data dependent policies. So they might give an indication, but keep the exact date open. That would be fair.

A combination of positive responses to questions 2) and 3) could see the EUR appreciate against the backdrop of a Fed that is talking a very optimistic game, but if the stock market is any guide, is beginning to worry financial markets with their gung-ho approach.

## Author

### Robert Carnell

Regional Head of Research, Asia-Pacific

[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.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>.