

27 August 2018
Opinion

More tightening coming from the Fed

Jackson Hole revealed a lot of things we already knew. Rates are going up in the US in September, and probably December. After that, it is back to data dependency.

Boring can be good

Although I think that there is a lot wrong with the framework of monetary policy in most central banks, including the US Federal Reserve, I'm still fairly comfortable with what the Fed under Jerome Powell is currently doing. Put that in perspective, I am happier that Fed policy is on a sensible and prudent if rather boring and predictable tightening path. I can't say as much for the ECB, though so long as they follow through with their hints of an Autumn taper and a December end to quantitative easing, then I will concede that monetary policy there too is finally heading in an appropriate direction.

So Powell's speech - anything new? Powell's strategy remains rather backward-looking given the lagging nature of monetary policy on the economy, and on the lagging nature of inflation in the business cycle. That poses a handicap, and means that policy can be headed in the wrong direction for quite a while before signals are received that can reverse pro-cyclical policy influence. But the cautious nature of the Fed's approach also means that the degree to which that is likely to happen is reduced. So pros and cons. Room for improvement certainly, but relatively safe.

I also particularly liked Powell's suggestion that the consumer price inflation sensitivity to monetary excesses was these days less than that of financial market prices. This could be used as an argument, not for asset-level targets, as some have suggested, but taking more heed of underlying credit growth relative to the growth of the economy. This is a lesson which I don't think was learned in the global financial crisis but should have been. Of course, the ECB (in theory) does this. In practice, the second pillar of their monetary policy has been a withered limb for many years. This is one that would be worth paying greater attention to.

Sticking this all together, there is no doubt that the Fed will hike again in September, and there is also rapidly declining doubt about a similar tightening from them in December. Then, as comments raised by the ever-dovish (but also ever thought-provoking) James Bullard, and the recently vacillating Raphael Bostic suggest, that may take policy sufficiently into neutral territory that a pause for reflection becomes sensible. I would favour that. Boring is a consequence of steady monetary policy. It should not be a goal in its own right.

Where the MXN leads, the CAD may follow?

Signs of a NAFTA bilateral deal between the US and Mexico have been helping bolster the MXN in recent months. An announcement may be made as soon as today. If so, the first to cheer may be the Canadians, who will look to re-enter talks with the US and use the Mexico deal as a springboard to a deal of their own. That should also provide the CAD with some further support, to build on the last two months of very gradual appreciation.

Day ahead

Its a quiet start to the week, with much of the G-7 on vacation for late-August public holidays, so nothing to watch there on the data calendar.

Here in Asia, China industrial profits will provide the main interest. A 20% year-on-year growth rate in June looked like confirming a gradual slowdown in Chinese profit growth, but at comfortably high levels. But there has been a lot of water under the bridge since then, not least, the intensification of the trade war. The Shanghai composite index is down 23% since its January high. It may take a stronger signal than a simple confirmation of still reasonable profit growth to turn this around.

Robert Carnell

Chief Economist Head of Research, Asia-Pacific

+65 6232 6020

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 NV 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. The producing legal entity 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 subject to limited regulation by the Financial Conduct Authority (FCA). 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.