

Federal Reserve: Dovish Fed signals end to tightening

No policy change from the Fed, but the dot plot diagram shows FOMC members have gone signalling two possible hikes to no hikes in 2019. Should we be worried?



Source: Federal Reserve

VERY patient

As widely expected the Federal Reserve unanimously left monetary policy unchanged with the funds target range maintained at 2.25-2.50%. The Fed noted the ongoing "strong" labour market, but also highlighted that growth has "slowed from its solid rate" in Q4. The statement also repeats the argument that with "muted inflation" the Fed will be "patient" with regard to future moves in interest rates.

The accompanying forecasts and "dot diagram" indicate that the Fed will be very, very patient. Having signalled back in December that it was thinking they could raise rates twice this year they are now projecting no rate changes in 2019 at all. In a further adjustment, they will be tapering their balance sheet roll off to US\$15bn per month of treasuries from US\$30bn with the process being halted by the end of September.

Unsurprisingly the dollar has reacted negatively to this and treasury yields have fallen too. We had expected officials to take one of their projected hikes out of the diagram for this year, but removing both is a surprise. It seems pretty aggressive given officials have been repeatedly telling

us that the US economy is "strong". Indeed, they have only cut their 4Q19 GDP growth forecast from 2.3% to 2.1% and left their core inflation forecast at 2%.

Creeping concerns

Such a move will only boost the market conviction that the next Federal Reserve move will be an interest rate cut. Concerns over economic headwinds such as trade protectionism, the government shutdown, weak figures from Europe and China (which Jerome Powell emphasised in the press conference) and the lagged effects of higher interest rates and the strong dollar all do justify caution. The recent weak run of US activity data has also been disappointing while core inflation has undershot expectations. However, today's sharp shift from the Fed may risk exacerbating any business and household concern about the outlook.

Should we be worried?

We had been thinking that a September rate hike from the federal reserve remained on the table given our belief that the US growth story was underpinned by a strong jobs market and rising worker pay and the expectation that in the coming months we will get a positive resolution to the US-China trade dispute. Indeed we continue to think the US economy can expand in excess of 2% this year with Jerome Powell also talking of "very strong" economic fundamentals. We additionally expect core inflation to grind higher to above 2.5%. However, this does not appear to be enough for officials and we will seemingly need to see even stronger figures to get the Fed to react.

Calling the top

Given such clear direction from officials and the continued emphasis on "patient", it looks as though we will have to take that September hike out of our forecast. For now, the Federal Reserve is still signalling a bias to tighten policy given the rate hike pencilled into 2020. But with a presidential election later in the year and President Trump keen to gain political capital out of challenging the Fed on any rate hikes, we are sceptical that would happen.

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.