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Snap

US: Fed's Powell suggests bias for rate hikes

New Fed Chair Jay Powell's testimony to Congress suggests ongoing gradual policy tightening, but there are hints of upside risks for rates

Powell's key messages

Jay Powell's first testimony before Congress as Fed Chair emphasises continuity from Chair Janet Yellen with a repeat of the policy of gradual rate hikes. Ahead of his testimony, there was some speculation that he could adopt a slightly more dovish stance, but the written submission doesn't back this up. Instead, Powell suggests the economic outlook "remains strong" while stating "some of the headwinds the U.S. economy faced in previous years have turned into tailwinds", namely fiscal policy and foreign demand.

He also hints that inflation is likely to rise, repeating Yellen's position that some of the "shortfall" in inflation likely reflects "transitory influences that we do not expect will repeat". He also sounds fairly relaxed about the recent market volatility, saying that despite this, "financial conditions remain accommodative". Moreover, financial conditions are not "weighing heavily" on the economy.

Interestingly, he also addresses prescriptive monetary policy rules, which many Republicans wanted the Fed to adopt formally when setting interest rates. He acknowledged that they can be helpful, but then repeated the standard criticism that when setting policy "careful judgments are required about the measurement of the variables used, as well as about the implications of the many issues these rules do not take into account".

We look for four rate hikes this year

As such, the tone of Powell's written testimony suggests that the Fed position hasn't really changed under its new leadership with gradual hikes remaining the theme. However, his hints at the upside potential for inflation and the increasing positives for growth suggest the risks are skewed towards a more aggressive monetary policy response. At the moment the Fed is projecting three rate hikes this year while financial markets are currently pricing in around 80bp of rate hikes. Given our above-consensus 3% GDP growth forecast for 2018 and the potential for inflation to rise more quickly than many in the market anticipate (wages, dollar weakness, medical care costs, cell phone data distortions, commodity prices), we are now forecasting four rate rises this year. We look for one every quarter – starting with the March 21 FOMC meeting.

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