

US: Powell's cautionary tale

Recent data flow has offered hope of a more vigorous economic rebound than we initially thought possible. The Fed remains wary though, with a renewed wave of infections arguing for caution. As such, Powell again emphasised policy will remain ultra-loose with the potential that they could have to do more to ensure the recovery continues



Fed Chair, Jerome Powell

A long way from normality

Chairman Powell's semi-annual monetary policy testimony to the Senate reinforces the view that while the Fed is encouraged about the recent data flow as the economy re-opens, we are a long way from "normality" and that won't arrive there is confidence we have overcome Covid-19.

While economic indicators "have pointed to stabilisation, and in some areas a modest rebound", the levels of output and employment remain "far below" their pre-pandemic levels. He highlighted the uncertainty over the economic outlook and reminded his politician audience that "the longer the downturn lasts, the greater the potential for longer-term damage", citing persistent unemployment as a key fear.

In this regard he again placed great emphasis on inequality, pointing out that "those least able to withstand the downturn have been affected most" with minorities, women and low-income

households disproportionately carrying the burden of the economic hardship.

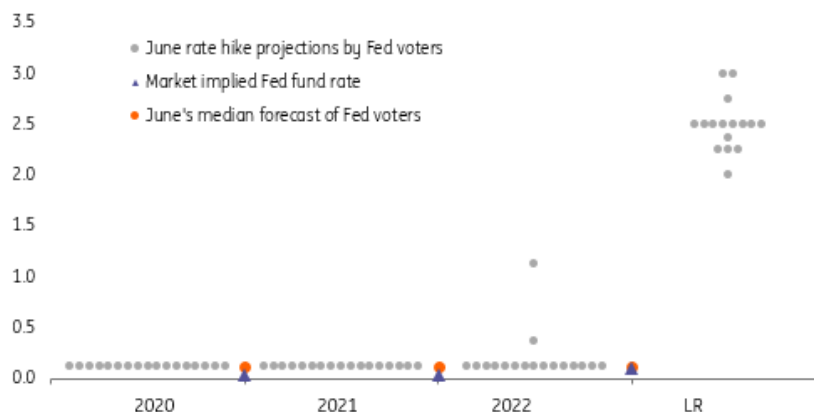
He again, tries to provide a reality check to the optimism in risk markets, such as equities, which are seemingly seeing only good things ahead. He warned of the risk of insolvencies, particularly in the small business sector and suggested that “until the public is confident that the disease is contained, a full recovery is unlikely”. Given a vaccine appears some way off and fears over a pick-up in Covid-19 cases in several states, he is clearly sitting on the more cautious side of the fence.

Ready to do more

Inflation (nor deflation) is not a concern for the Fed, with long-term inflation expectations having remained stable despite sharp price falls in some components (apparel, gasoline, air travel, etc) and sharp rises in food over the past couple of months. Nonetheless, on balance, inflation is “likely to remain below our objective for some time”. We certainly agree given mass unemployment will keep wage pressures benign with the widening output gap further depressing price pressures.

Given the scale of the downturn and the lack of inflation threat the Fed remains committed to keeping the Fed funds rate at the 0-0.25% level “until we are confident that the economy has weathered recent events and is on track to achieve our maximum-employment and price-stability goals”. He was asked about yield curve control, but his response was merely that discussions were at an “early stage”. With the 2Y anchored at 0.2% and the 10Y at just 0.7% we see little need unless rising treasury issuance was to put upward pressure on borrowing costs that would translate into tighter credit conditions in the broader economy.

Fed "dot plot" for part of Fed funds target range



Source: Federal Reserve, ING, Bloomberg

Threats to the economy are set to linger

In our view, the recent data flow has been encouraging with retail sales, housing indicators and confidence all looking very positive. It appears we will need to revise up our 2Q GDP forecast, which is currently at -38% annualised contraction, but the outlook for the second half of the year remains very uncertain. At present, the US\$600 per week additional boost to unemployment benefits is clearly helping impacted families, but is scheduled to end in late July and if it doesn't get extended we could see consumer activity drop back sharply. After all, employment is still 20 million lower than at the beginning of the year and given social distancing constraints job opportunities in retail, hospitality, hotels and travel will

remain limited.

Then as Jerome Powell states, we cannot signal the all clear until Covid-19 is beaten, or at least properly contained. The recent spike in new cases in several states suggests we need to make much more progress here, with the threat that renewed lockdowns could have a massive impact on confidence, risk assets and of course economic activity.

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.