US Fed: Subtle changes hint at upside risks to rates

Some modest changes regarding the inflation commentary suggest an ongoing appetite to raise interest rates

Source: Federal Reserve, Flickr

Inflation risks subtly shifting?

Janet Yellen's last FOMC meeting as Fed Chair sees monetary policy left unchanged (unanimous vote) with the accompanying statement appearing to be only modestly changed from the one issued in December. Expectations ahead of the meeting had been that the Fed might make a clear signal regarding a March hike, but in the end they have given Jay Powell plenty of room for manoeuvre.

There was perhaps an acknowledgement of slightly stronger price pressures in the statement, but it is marginal. They removed the comment that inflation "will remain somewhat below 2% in the near term" while added that measures of inflation compensation "have increased in recent months", but also state that they "remain low". They continue to think inflation will "stabilize around the Committees 2 percent objective" while "near term risks to the economic outlook appear roughly balanced".

In another change, the Fed also subtly added the word "further" to the sentence saying they expect economic conditions to “warrant further gradual increases in the federal funds rate”. They also removed the description of hurricane-related issues in the data, which is unsurprising given the vast bulk of the distortions have worked their way through now.

Like the Fed itself, we are forecasting three 25bp interest rate increases this year. However, the potential for another, more damaging, government shutdown, the likelihood core CPI will remain below 2% until after the March FOMC meeting and the possibility that bad weather could hurt activity data mean we are not currently forecasting a 21 March hike. However, should these threats subside we will likely have to change that – probably inserting it as a fourth hike rather than just shifting forward the three 2018 moves we are currently predicting.

Yellen's legacy

Despite not being re-appointed by President Trump, Janet Yellen can look back on her tenure as Fed Chair with pride. The US economy is growing at a 3% rate, inflation is close to its 2% target and unemployment is at a 17-year low so she has ticked all of the boxes in terms of economic targets. At the same time, the Fed has moved interest rates away from the zero lower bound and is also starting to shrink its massive balance sheet.

She also leaves behind a safer, more secure financial system – her principles of not wanting to see regulations watered down was probably one of the reasons Trump didn’t back her for a second term. Also, from Trump’s perspective, she should arguably be viewed as one of the “greatest” Fed chairs ever, delivering stock market gains of more than 60% during her four-year tenure. So overall, a tough benchmark for Jerome Powell to beat.

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