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US: Discomforting dots

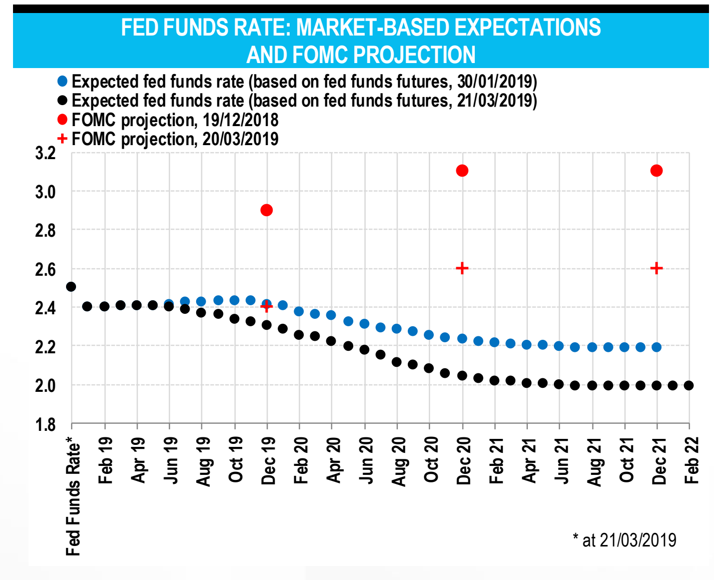
■ The growth projections of the FOMC members have been revised downwards and the unemployment projection has seen an upward revision ■ The projections for the federal funds rate (the "dots") have dropped 50 basis points ■ The Fed chairman considers the outlook to remain favourable, adding that it is a great time to be patient ■ Markets are less upbeat. They interpret patience as an underlying concern about downside risks and price a rate cut in the course of next year. We expect the policy rate to stay at its current level, this year and next.

The new projections of the members of the Federal Open Market Committee are sobering. The median growth projection for this year has been revised from 2.3% to 2.1% and it has been trimmed for next year as well (from 2.0% to 1.9%). The change in the range of individual projections for 2019 is more significant (from 2.0-2.7% to 1.6-2.4%). The unemployment rate at the end of this year is now expected at 3.7% (from 3.5%). The projection for core inflation remained unchanged. Perhaps the most eye-catching is the 50 basis points downward adjustment of the projection for the federal funds rate, which is now expected to be at 2.4% by the end of this year and 2.6% thereafter, implying one rate hike in 2020.

Perhaps as a counterweight to these downward adjustments, during his press conference, Jerome Powell insisted repeatedly on the favourable outlook and the good fundamentals (employment growth, low level of unemployment, attractive levels of consumer and business confidence), whilst adding that the data did not send a signal to change rates in one or another direction.

According to the Fed Chairman "*it's a great time to be patient*" when the outlook is favourable, inflation is under control and the policy rate is at a neutral level. Yet, it looks as if the repeated insistence on the need for being patient before contemplating the next move is interpreted by markets as reflecting an underlying concern about downside risks to the outlook. Projections pointing towards slowing growth and a moderate increase in the unemployment rate may contribute to this reading. As a consequence, as shown in the chart, the federal funds rate (inferred from the futures curve) is expected to decline in the course of 2020. The curve was already downward sloping at the end of January but since then it has dropped an additional 20 basis points for the second half of next year and beyond. Clearly, an upward shift remains a distinct possibility. It all depends on the data. However, given the guidance provided by the FOMC projections and the Fed Chairman, it looks as though the bar for ending up with a positively sloped federal funds rate curve –which would imply that the market expects rate several hikes again-, is high. In our view, the policy rate will remain at its current level this year and next.

FED FUNDS RATE: MARKET-BASED EXPECTATIONS AND FOMC PROJECTION



Source: Thomson Reuters, BNP Paribas

William De Vijlder

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