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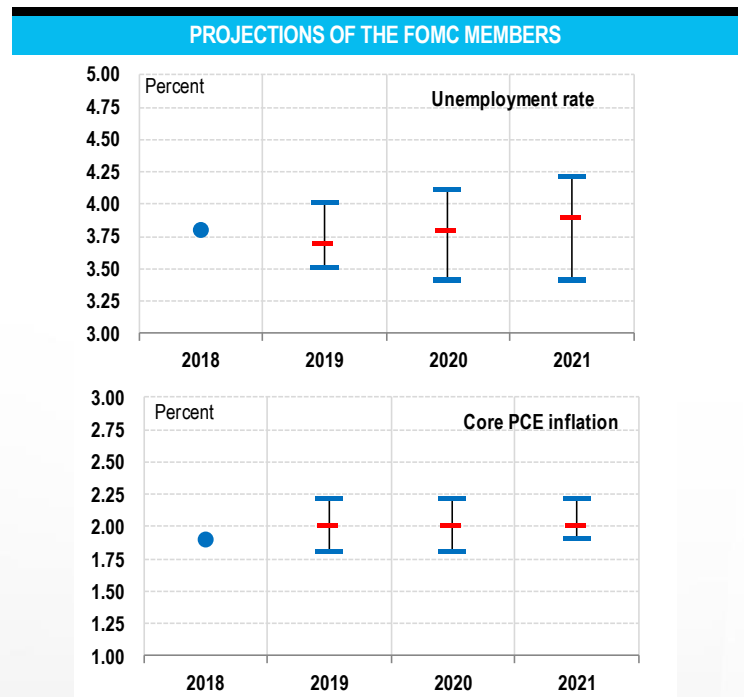
US: Three different messages from Washington DC

■ President Trump has argued that the US economy would get a boost if the Federal Reserve were to cut rates ■ The minutes of the FOMC show the members are confident about the growth outlook. The outlook for inflation, against a background of global uncertainties, allows them to be patient in terms of policy ■ The IMF in its latest Global Financial Stability Report expresses concern about how high debt levels weigh on the resilience when faced with significantly slower growth or higher borrowing costs ■ This implies that Fed policy will not only be confidently patient but also patiently vigilant

Recent comments and analyses about the US show that the perspective drives the messages. Hence the messages are different, not to say conflicting. President Trump argued last week that the economy would climb like a rocket ship if the Fed would cut rates, adding that the central bank had slowed down the economy. Considering that next year is an election year, it doesn't come as a surprise that politicians closely monitor the health of the economy. It is reminiscent of the famous line *"it's the economy stupid"* from Bill Clinton's successful campaign against George Bush sr. for the 1992 presidential elections.

From the perspective of the Federal Reserve, the focus is on meeting the policy objectives. The minutes of the March meeting show that the committee members are quite relaxed about the economic outlook with their projections pointing towards ongoing good growth (slightly above potential), a low rate of unemployment and inflation which remains under control. Compared to December, their uncertainty about the outlook hasn't really changed although the risks of a pick-up of the unemployment rate and a decline of inflation have increased, but only slightly so (charts on next page). The minutes also show that the Fed staff is confident about the outlook: the first quarter slowdown should be transitory and growth is expected to bounce back solidly in the second quarter. Moreover, it considers uncertainty around its projections to be in line with the historical average, whereas risks to the outlook are roughly balanced. All in all, this leads to a central bank which is confidently patient: confident about the growth outlook but waiting patiently before contemplating any new action on official rates. Why hurry when inflation is stubbornly close to target and foreign headwinds haven't disappeared?

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Source: Federal Reserve, Minutes of the March meeting of the FOMC, BNP Paribas

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BNP PARIBAS

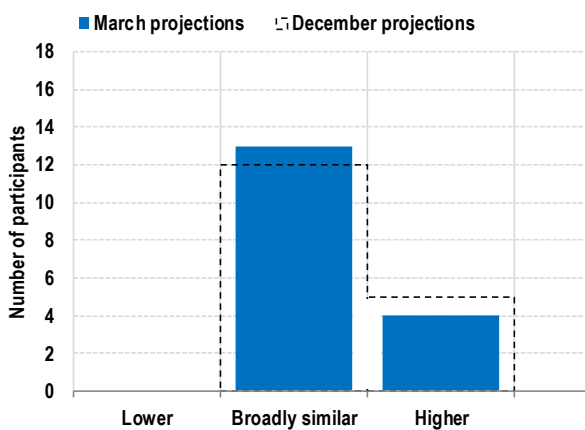
The bank
for a changing
world

The minutes report that “A few participants observed that the appropriate path for policy, insofar as it implied lower interest rates for longer periods of time, could lead to greater financial stability risks. However, a couple of these participants noted that such financial stability risks could be addressed through appropriate use of countercyclical macroprudential policy tools or other supervisory or regulatory tools.” Moreover, “a few participants observed that an economic deterioration in the United States, if it occurred, might be amplified by significant debt service burdens for many firms.” A link can easily be made with the IMF’s new Global Financial Stability Report, “Vulnerabilities in a Maturing Credit Cycle”. In this report the authors point towards a US corporate credit cycle which appears to be at its highest point in recent history (though lower than in some other countries); corporate debt is skewed towards lower-rated issuers; leverage is at cyclical highs in most ratings buckets. This has happened, quite logically, against the background of prolonged monetary accommodation and a global expansion. However, when these cyclical support factors turn into headwinds, the implications of reduced resilience should manifest themselves: increased sensitivity

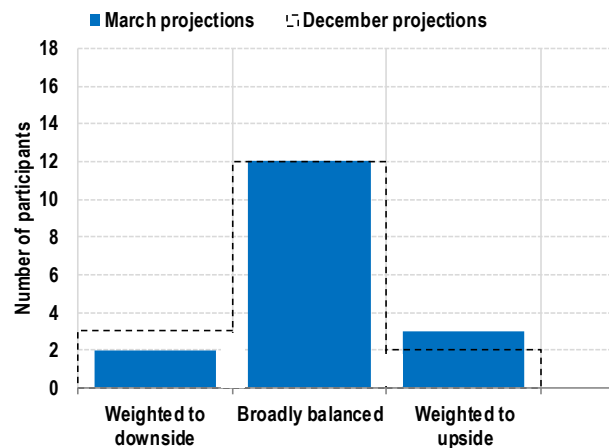
to lower earnings or to an increase in interest rates, following a rise in the corporate spread versus treasuries if recession risks were to mount. The extent of the downturn then becomes particularly important: “Although corporate balance sheets are strong enough to sustain a moderate economic slowdown or a gradual tightening of financial conditions, a significant deceleration in earnings growth or a sharp tightening of financial conditions could lead to a notable deterioration in corporate credit quality.” One should also be concerned about contagion effects starting from lower-rated issuers, which will suffer more from a deterioration in the macro environment. This may end up impacting higher quality corporates as well, via their business with financially constrained firms and a deterioration in their own funding conditions, with banks and investors turning more cautious across the board. The lagged effects of monetary easing to counter such a tide, create a two-fold challenge for the Fed: avoiding to tighten too much when the environment still looks good and making sure to ease sufficiently quickly when the outlook worsens. The policy is not only confidently patient, it will also be patiently vigilant.

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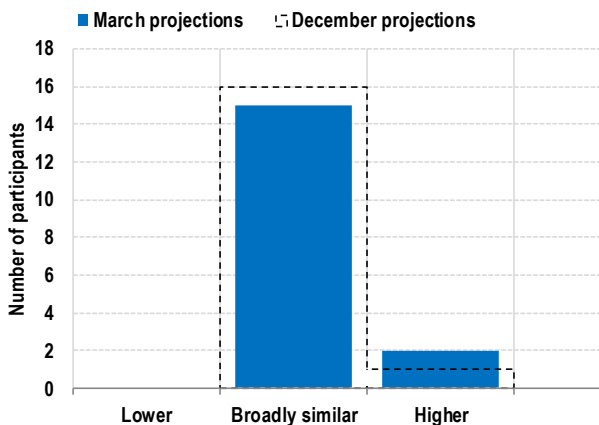
UNCERTAINTY ABOUT THE UNEMPLOYMENT RATE



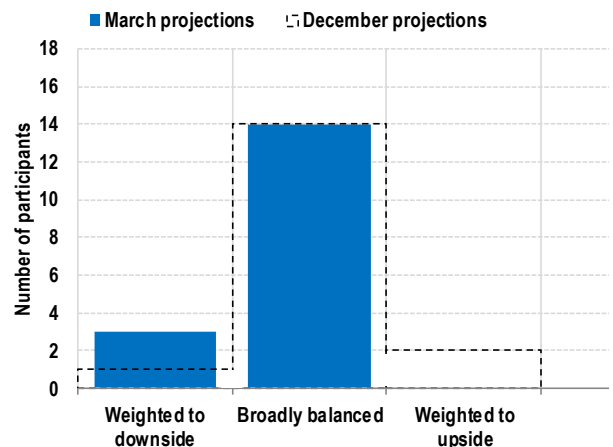
RISKS TO THE UNEMPLOYMENT RATE



UNCERTAINTY ABOUT PCE INFLATION



RISKS TO CORE PCE INFLATION



Source: Federal Reserve, Minutes of the March meeting of the FOMC, BNP Paribas

