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USA

Fed still on hold

As expected, the US Federal Reserve left the federal funds target range at 0.50%-0.75% and continued to signal that rates would be lifted gradually. However, the Fed left the timing of the next move open. A hike earlier than the June meeting of the Open Market Committee cannot be ruled out, but this would wrongfoot markets. Against this backdrop, an intermittently even softer euro combined with substantially higher inflation in the eurozone would further highlight the need to end the ECB's bond purchasing program.

The Fed's assessment of the economic outlook appears to be largely unchanged since the last meeting in mid-December. We see no substantial changes in the post-meeting statement.

The Fed continues to expect moderate economic growth, further improvement on the labor market and a rise in inflation to the 2% target in the medium term. The central bank also describes the risks to the short-term economic outlook as roughly balanced. The strategy to normalize rates gradually thus remains intact. In December the Fed had flagged up three rate hikes for this year.

But the Federal Open Market Committee gave no discernible hint that the next move would already ensue at the forthcoming meeting in mid-March. Nonetheless, this cannot be ruled out. In one of the few additions to the post-meeting statement the Fed notes that consumer and business sentiment indicators have improved in recent months. We think that the, in some cases, marked pickup since November reflects not only the more favorable underlying trend in economic activity, as evident in the robust labor market performance as well as the rebound in business investment. Sentiment is evidently also being buoyed by the expectation that the new administration

will implement tax cuts and sweeping deregulation measures. To this extent, it is hard to judge whether the upbeat assessments will already feed into spending decisions in the short term. Should the "hard" indicators come in stronger than expected, it is conceivable that, on presentation of the Monetary Policy Report to Congress in mid-February, Janet Yellen will indicate a bias towards an imminent rate hike.

This would wrongfoot the markets, which are currently assuming a rate hike in June. Exchange rates are then also likely to shift anew. Against this backdrop, an intermittently even softer euro combined with substantially higher inflation in the eurozone would further highlight the need to end the ECB's bond purchasing program.

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