ECONOMIC RESEARCH

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USA

Cautious monetary policy normalization

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Although the Federal Open Market Committee (FOMC) remained on hold again at yesterday's meeting, it is sending very clear signals that it is moving towards a rate hike before the end of this year. Three FOMC members voted for an immediate hike. Moreover, a majority of participants continues to view at least one rate hike this year as appropriate. And the Fed now views the risks to the economic outlook as roughly balanced. The two rate hikes signaled for next year chime with our assessment of the normalization pace.

With regard to economic developments in the second half of the year the Fed is upbeat. Although in its updated economic projections real gross domestic product is now expected to increase by only 1.8% over the course of 2016, given the subdued performance in the first two quarters of this year this implies a very solid pace of growth in the region of 2½%-2¾% (annualized) in the second half of the year. The motive behind remaining on hold probably lies in the fact that the Fed is waiting for clearer evidence that the economic expansion is on a broader footing. Of particular importance is likely to be that signs of an upswing in business investment become entrenched.

Overall the Fed continues to paint a basically positive picture of the economic outlook in its projections, which now stretch into 2019: moderate growth, improvement on the labor market and gradual pickup in inflation towards the 2% goal. Accordingly, the Fed considers a gradual correction in its monetary policy stance with rate hikes of 200 basis points in the years 2017 to 2019 appropriate. For next year the Fed is signaling two rate hikes. This chimes with our assessment of the pace of interest rate normalization.

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