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Fed reaffirms gradual normalization of monetary policy

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As expected, the Fed has left its target rate for the federal funds rate at 0-0.25%. At the same time it continues to signal that the first rate hikes could take place this year. However, there seems to be a growing inclination to hike only once. In any event, the Fed underscored its message that the normalization of monetary policy would be only gradual.

On the key points, the statement on the monetary policy decisions was little changed compared with the end of April. Above all, the Open Market Committee confirmed the outlook for monetary policy, indicating that a rate hike would be warranted if, given further improvement in the labor market situation, the Fed was reasonably confident that inflation was moving back towards the 2% target in the medium term. To this extent, monetary policy remains clearly data-dependent.

As usual, updated economic projections and year-end rate forecasts by the participants of the FOMC meeting were presented. At 1.9%, GDP growth in the course of 2015 was trimmed significantly from the March figure (2.5%). This is likely to be largely due to the poor start to the year, with the Fed still talking of “moderate” growth going forward in its statement. For 2016 and 2017 the forecast is also for slightly above-trend growth. Accordingly, the unemployment rate in the coming years is expected to dip below the rate viewed as normal of just over 5%.

With fundamentally little change in the economic projections, the corrections in the rate projections are also limited. Taking the median, however, the rate path is flatter than signaled hitherto. By end-2017 the Fed governors and the presidents of the Federal Reserve banks expect rates to be raised to 2¾%-3% (March projection: 3%-3¼%). he median for end-2015 is unchanged at 0.625% and is thus fundamentally in line with two rate moves in the second half of the year; however the distribution around that figure has changed significantly compared with March. Whereas in March only three participants expected fewer than two rate hikes, the number has now risen to seven. We are still assuming an initial rate hike in September. But at the same time we see confirmation of our assessment that the Fed will tread cautiously when raising rates. There is therefore a considerable likelihood that the Fed will either wait until the final quarter of 2015 for lift-off or will take a longish pause following a September move.

These assessments are, as always, subject to the disclaimer provided below.

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