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USA

The Fed is not impatient

Thomas Hofmann
Phone +49.69.24431-4912
t.hofmann@allianz.com
Allianz SE
https://www.allianz.com/economic-research/en

Allianz Research
https://twitter.com/AllianzResearch

As expected, the US Federal Reserve has changed its forward guidance, thus in principle paving the way for an initial rate move in June. However, the cut in year-end projections for inflation and policy rates suggests that lift-off might not take place until the second half of the year.

Above all following the statement to Congress by Federal Reserve Chair Janet Yellen on the presentation of the Monetary Policy Report in late February, the modification of the forward guidance is no surprise. By dropping the reference that it could be patient in beginning to normalize the stance of monetary policy, the Fed has given itself more flexibility. Monetary policy decisions are now totally data-dependent. As a rate hike in April is explicitly described as unlikely, lift-off could in principle come at the meeting after next in June.

However, at the press conference Yellen stressed that removal of the word "patient" did not necessarily mean a rate hike at that point. The forward guidance now contains the reference that, given further improvement in the labor market, a rate hike would be appropriate if the committee is reasonably confident that inflation is heading back to the 2% objective over the medium term.

In this context, the updated economic projections suggest that the Fed will bide its time. With its downwardly revised inflation forecasts, the Fed is signaling that the return to the target figure will probably take longer than previously thought. And the lowering of the projection for core inflation over the course of 2015 by 0.3 percentage points to 1.35% reflects not least the dampening effect of exchange-rate induced lower import prices.

The trimmed inflation forecast probably carries more weight than the more favorable outlook for the unemployment rate, particularly as the Fed has also marked down its estimate of the normal longer-run rate of unemployment.

For, against this background, the participants at the FOMC meeting lowered their projections for appropriate policy rates at year-end 2015 to 2017 appreciably. Taking the median figure, the rate path is at least 50 basis points lower than the last projection in December. For end-2015 the figures imply a target range for the federal funds rate of 0.5%-0.75%. Against this backdrop, we are still assuming that the Fed will not enact an initial rate hike until the second half of the year, probably in September.

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