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U-turn in US interest rate policy

The US Federal Reserve surprised the markets last week with the announcement that there will (probably) be no increase in the rate this year. As recently as December, its Board of Governors assumed an interest rate adjustment of 0.5% in 2019 and a further 0.25% in 2020. It was also announced that the sale of securities accumulated during the period of the extraordinary monetary measures would soon be discontinued. As a result, the central bank's balance sheet will not be normalised. The markets (measured by the implicit interest rates of the Fed fund futures) even believe that the interest rate has peaked and that a rate cut is possible in the course of the year.

Has the Federal Reserve caved in to pressure from Trump, or is the official explanation that the slowdown in the international economy is bringing increased risks for the US economy correct? We clearly tend towards the latter reason, much as we are surprised that the robust US economy should appear so vulnerable. The problem with monetary policy is that it has no stable reference points. Specifically, it is not clear at what interest rate level monetary policy is neutral and where it has a dampening effect on growth. All we know is that this neutral interest rate has fallen significantly in recent years and the current interest rate for Fed funds is likely to correspond to this level. A further rate rise with the usual time lag would then exert a dampening effect on the US economy – and this in the aforementioned clouded global economic picture and continuing relatively muted US inflation. In good tradition, the Fed decided not to endanger the growth dynamic and rather accept an overshooting of the inflation target, eventually.

Stock markets at the end of last week were hit by the spectre of a recession on seeing the US yield curve invert temporarily. While it is the case that every US recession has been preceded by a phase of inverse interest rate structure, this phase has persisted and been clearly identifiable in terms of its scale.

We believe that we are going through a phase of economic slowdown, particularly in Europe. The measures being taken in China, such as tax cuts and accelerated credit growth, the gradual loosening of fiscal reins in the euro area and the turnaround in US interest rate policy are suggesting a possible acceleration in global growth in the latter half of the year. Given this backdrop, stock markets are not really at risk of

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collapse. This, however, all depends on the US and China reaching an agreement capable of easing trade tensions in the long term.

Wangs, March 2019