27 February 2018

Flash Comment US

Powell says 'personal outlook has strengthened'

Our interpretation of Fed Chair Powell's testimony before the House of Representatives' Financial Services Committee is that **he was being slightly hawkish**, especially during the following Q&A session (no big changes in the prepared speech). Being asked about what would cause the Fed to hike more than three times, **he said that *'his own personal outlook has strengthened'* since December, as economic data have been strong**.

In his prepared speech, we want to highlight two things. Firstly **Powell said that headwinds have turned into tailwinds** due to a combination of stronger global growth and expansionary fiscal policy. Secondly, **Powell used the words 'overheated economy' trying to describe the Fed's dilemma**, as the unemployment rate and inflation are low at the same time (see our *tweet*). Also noteworthy was that Powell said that he *'personally'* likes to look at different policy rules going into FOMC meetings. In its *Monetary Policy Report – February 2018* (released Friday 23 February) the Fed describes a few rules – see our *tweet*. In the Q&A session, **Powell said that 'all else being equal' looser fiscal policy should be offset by tighter monetary policy** but did not directly answered whether it would be one-to-one.

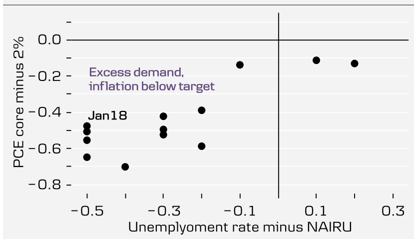
Markets also interpreted Powell hawkishly, especially during the Q&A session. US 2yr Treasury yield rose 4bp to 2.26% while EUR/USD fell from 1.2320 to 1.2236 at the time of writing. S&P500 also fell 0.7% from its intraday peak during the Q&A.

We believe the Fed will stick to its '3 hikes' signal for 2018 at the upcoming meeting in March but that some of the six members currently indicating two or fewer hikes will lift their dots thus showing more confidence in the outlook. It will also be interesting to see what happens in relation to 2019 where the Fed currently indicates two hikes (taking the Fed funds rate to the longer-run dot of 2.75%, which is the level where monetary policy is neither expansionary nor contractionary). **We think the signal for 2019 will be raised to three hikes (it was already borderline last time) hence signalling they want to start hitting the brakes by moving rates above the natural rate of interest due to expansionary fiscal policy**. This should not change our view that fiscal policy is not offset one-to-one meaning inflation is still set to move gradually higher, see *Part 1: Global Inflation – US stimulus and closing output gaps pose upside risk*, 26 February.

Today's key points

- *Flash Comment US – Fed Chair Powell is 'Yellen in disguise' amid discussions about price level targeting,* 24 January
- *Part 1: Global Inflation – US stimulus and closing output gaps pose upside risk,* 26 February

Powell emphasises the Fed dilemma: Low unemployment & low inflation at the same time



Source: BLS, Federal Reserve, Macrobond Financial

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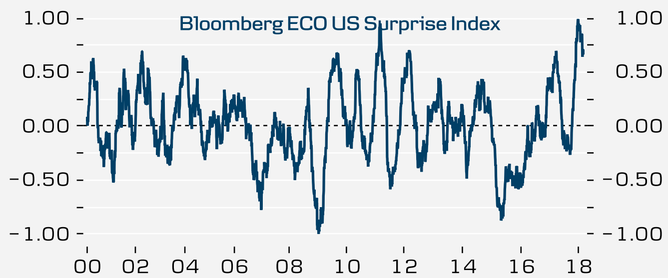
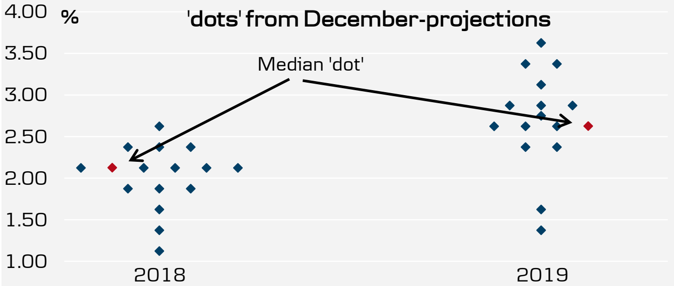
Powell says *'his personal outlook has strengthened'*, as data remain strong



Source: Bloomberg, Macrobond Financial

Fed signals three hikes this year and two hikes next year



Source: Federal Reserve

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Mikael Olai Milhøj, Senior Analyst.

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Expected updates

None.

Date of first publication

See the front page of this research report for the date of first publication.

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