ISSN: 1791-35 35

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GLOBAL ECONOMIC & MARKET OUTLOOK
February 18, 2016
Eurobank
FOCUS NOTES

January FOMC minutes: Broadly consistent with recent Fed rhetoric

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- Reiterating the conclusion of the January post-meeting statement, the minutes from the January 26-27 FOMC meeting revealed a rather uncertain committee about how to interpret the global economic and financial developments in the economy, emphasizing the importance of closely monitoring these events and of assessing their implications for the labor market and inflation, and for the balance of risks to the outlook. According to the minutes of the said FOMC meeting, if the recent turbulence in global financial markets were to persist, then the effects could be "roughly equivalent to that from further firming in monetary policy". Nevertheless, most policymakers judged that it was "premature to alter appreciably" their views on medium-term growth prospects. That said, FOMC participants noted that labor market conditions, which had continued to improve, tend to provide a more reliable early reading on the economy's underlying strength than other measures of activity, including the preliminary weak Q4 GDP growth.

- With regards to the inflation outlook, most participants expected that a return of inflation to the 2.0% target "would take somewhat longer than previously anticipated" in view of the downtrend in oil prices and continued USD appreciation. The Committee seemed split concerning views on market inflation expectations, as some participants saw market-based measures of longer-term inflation expectations as consistent with well-anchored long-run expectations, while some others highlighted that inflation expectations have declined to historically low levels. It should be noted that since the January meeting, long-term inflation expectations in consumer surveys have fallen, probably raising some concern among those participants who have cited survey-based measures of inflation expectations as broadly stable. Indeed, the preliminary February estimate for the University of Michigan index of consumer sentiment revealed that long-term inflation expectations fell by 0.3pp to 2.4%, the lowest rate since the survey began in 1979. Adding to this, St Louis Federal Reserve President James Bullard, a hawkish FOMC member and a 2016 voting member of the committee, unexpectedly changed his view in a speech given last night on the favored monetary policy stance. In more detail, he highlighted that it as "unwise to continue a normalization strategy" on interest rates as market-based inflation expectations are fading.

- Along these lines, we believe that the Fed will stay on hold at least until the end of H1 2016 in order to have enough time to assess the balance of risks. Fed Funds Futures contracts currently show a 6% chance of a US interest-rate increase in March, compared with 40% two months ago, while the corresponding probability has declined below 50% for the remaining FOMC meetings of 2016. In our view, an improvement in upcoming macroeconomic data releases relative to the soft GDP reading in Q4 and a stabilization in global financial markets are necessary conditions for the next interest rate hike.

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