United States

You don't change a winning team

- **The flow of news from domestic spending darkened lately. Once more the first quarter will be disappointing. The improvement in regional business surveys is consistent with a rebound in Q2, though.**
- **During her first public appearance since the last FOMC meeting, Janet Yellen comforted us in our interpretation of the decision then taken.**
- **If projections are marginally changed, the risks surrounding them have heightened. Given the asymmetries affecting monetary policy at the zero lower bound (ZLB), a pause was the reasonable decision.**
- **Data-dependency is reaffirmed and for good reasons. According to Janet Yellen, its credibility has helped create a buffer from risks.**

Lately, data have been released on the soft side. Consumer spending for January was revised downwards (from +0.4% m/m to 0.0%) and February was not that dynamic (+0.2%). Before those new figures, real consumption was en route for a solid +2.4% (quarterly annualised rate) in Q1 ; now it looks like it will be closer to +1.4%. The culprits are a lower disposable income and a higher savings ratio. News from business investment was another cold shower, as the rebound in January new orders was short-lived. Shipments of non-defence capital goods (excluding aircraft), a coincident indicator of business spending on equipment and software, were down 6.8% in February (on a 3-month annualised basis). In end-2015, they had dropped by 5.1%, and it now seems that the Q1 performance will be even worse. In short, the first quarter will once more be a disappointing one: the nowcasting model from the Atlanta Fed (GDPNow), which began the quarter with upbeat readings (at one point, it was as high as 2.7%), now is down to 0.6% (Chart).

Whether the slowdown is to last is another question, and answers are few. At the time of writing March data for the manufacturing ISM still were not out, but regional surveys are unanimous in announcing a rebound. On the other hand, and even if consumers seem quite confident, the Conference Board index having rebounded in March, the overall message is not that optimistic. Beyond monthly ups and downs, consumer confidence is largely unchanged since the middle of last year, but the mix is less comforting, as expectations trend downwards, a balance that is confirmed by the other consumer confidence index, from the University of Michigan, and could explain the rising savings ratio.

As for now, we tend to favour the scenario of a rebound in the second quarter, as the labour market looks as solid as ever (bar a slowdown in the still to-be-released March labour market report). FOMC members would probably not disagree.

This week, Janet L. Yellen, the Fed Chair, gave her first public appearance since the March 15th-16th FOMC meeting. All in all, we

First quarter nowcasting

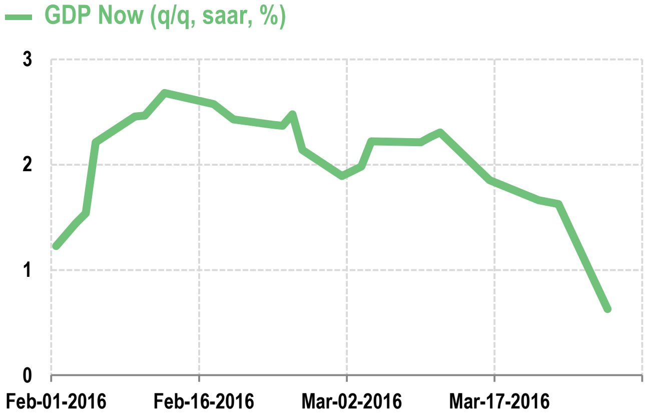

Chart 1 Source: Federal Reserve of Atlanta

read that speech as confirming our previous analysis of the reasons behind the pause in the process of normalising the US monetary policy[1]. In short, even if the outlook for the US economy is marginally different from what it was in December, risks are mounting globally and were those risks to materialise, the Fed would find it hard to fight them as the Fed Fund Target rate remains close to zero. On the other hand, if the US economy were to perform more buoyantly, and inflation were to accelerate more abruptly, monetary policy would easily help contain the associated risks.

Janet Yellen explicitly talked about this asymmetry of risks at the zero lower bound. But she also warned against "*overstating the asymmetries affecting monetary policy at the moment*". For sure, a central bank would never admit it lacks the necessary tools, and Miss Yellen emphasised what remains available: the ones that were successfully used during and after the 2007-2009 recession. Forward-guidance and quantitative easing proved efficient once, so there is no reason to either doubt them or consider adding negative rates to the list.

After the March FOMC meeting, there have been mounting critics of the Fed policy. The Fed was accused of time inconsistency, or to put it differently, to have changed its reaction function without warning. Last week, James Bullard, the St Louis Fed President, had already addressed the critic[2], claiming the Fed had not been time-inconsistent in March. This week, Janet Yellen addressed the critics that the Fed's communication is blurred. In essence she said: You say our communication sucks. I say it works fine: data-dependency is recognised enough by financial markets that they do adjust in real-time to data releases, "*resulting in movements in bond yields that act to buffer the economy from shocks. This mechanism serves as an important "automatic stabilizer" for the economy*". Fair enough…

[1] See "Safety first", Alexandra Estiot, Eco Week BNP Paribas, March 18th, 2016.
[2] "Time Consistency and Fed Policy", James Bullard, New York Association for Business Economics, March 24th, 2016.