

U.S. FOMC Review

- Yellen: still generally optimistic; expects further rate increases at some point

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Chair Yellen's speech today contained fodder for both bulls and bears, but we read her comments as generally optimistic and we view her as favoring additional rate increases sometime this year.

We were anxious to learn of her views on the May employment report, which she described as "disappointing." We viewed this as a tame description; others have used more forceful d-words: dismal, disastrous, devastating. In addition, she indicated that one should never attach too much significance to any single monthly report and that the overall labor market situation was still "quite positive."

Chair Yellen apparently has not altered her economic outlook as a result of the latest employment data: "I see good reasons to expect that the positive forces supporting employment growth and higher inflation will continue to outweigh the negative ones. As a result, I expect the economic expansion to continue, with the labor market improving further and GDP growing moderately." To be sure, she recognized downside risks because of slow growth abroad and weak exports. She also noted slow results in capital spending, but she saw this constraint as transitory. She remained optimistic about the economic outlook because of good support from consumer spending and residential construction. She also mentioned a favorable fiscal situation, with governments in total (federal, state, local) providing a small push to economic activity rather than restraining growth as they had in the prior few years.

Ms. Yellen has not changed her economic outlook appreciably, and her policy views seem to be little changed as well: "I continue to think that the federal funds rate will probably need to rise gradually over time to ensure price stability and maximum sustainable employment in the longer run." She was vague on timing, which opens the possibility of a long delay before the next rate hike, but she also noted that because of lags in policy the FOMC would need to move before its goals were fully reached. June seems to be off the table, and a July rate hike is highly uncertain as well, but the Fed Chair, in our view, was signaling that the next change in policy was upward.