Longer and Longer, Slow Growth Continues

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The Federal Open Market Committee (FOMC) continues to look for reasons to raise interest rates, yet this past Wednesday the Fed decided to maintain the federal funds target rate at the same range of 0.25% to 0.50% basis points. Fed officials had tentatively committed to two more rate hikes this year, but have now revised this guidance down to only one additional increase.

Low rates, as explained by Fed Chair Janet Yellen are the “new normal”, given that central bank officials expect rates and economic growth to remain low through 2018. Key indicators behind this dovish movement include both global macro factors and domestic woes in the economy. On the global front, anticipation of a possible British exit from the European Union has raised attention among economists and became one of the main reasons for the Fed not raising interest rates. Yellen, in her post-meeting news conference Wednesday, questioned how a “leave” vote could hurt the U.S. economy.\(^1\) Foreign events will continue to have influence in Fed decisions given the outsized dominance of the US dollar in global financial transactions. On the news that the fed funds rate remains unchanged, stocks initially extended gains, while the 10-year bond yield dipped from 1.61% to 1.58%.

Domestically, the US economy grew, but at a slower pace than expected by the Fed. The job market lost momentum with a weak payrolls report in May (38,000 jobs created on the non-farm payrolls)\(^2\). In the post-meeting statement, the Fed noted that the unemployment rate has declined to 4.7%, but “job gains have diminished.” The associated Labor Force Participation Rate dropped to 62.6%\(^3\), reflecting continued struggles related to full-time job creation. Consumer spending remained healthy, increasing 1% in April; disposable income also gained 0.5% for the month\(^4\). The FOMC statement noted that “household spending has strengthened” and that housing has improved.

In a subsequent Fed meeting on Friday, St. Louis Fed President, Jim Bullard, signaled a significant shift in his outlook when he stated that present conditions are likely to continue into 2019, while also calling into question the effectiveness and credibility of the Fed’s own economic forecasting ability\(^5\).

Continued slow growth and sustained challenges in the job market have raised concerns that the economy is experiencing what former U.S. Treasury Secretary Larry Summers calls “secular stagnation”, as opposed to just a standard “cyclical slowdown”.

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1 FederalReserve.gov
2 US Department of Labor
3 US Bureau of Labor Statistics
4 Bureau of Economic Analysis - May 31, 2016
5 Federal Reserve Bank of Saint Louis