

We expect the Fed to raise rates gradually in 2016, before moving to faster hikes as the forces for going slow fade...



Main drivers for the Fed

		Impact on US			
		Sign		Size	
		Inflation	Growth	2016	After
Global growth	<ul style="list-style-type: none"> * Moderate pace * Marginal pick-up in 2016 and 2017 	-	-	H	L
Labour market strength	<ul style="list-style-type: none"> * At full employment, to tighten more * Wage inflation low but rising 	+	+	M	H
Dollar strength	<ul style="list-style-type: none"> * +25% since mid-2014 * Further strength, at slower pace 	-	-	H	L
Low oil prices	<ul style="list-style-type: none"> * -50% in 2014, -25% in 2015 * Limited further downside in 2016 	-	+	H in H1	L
Higher rates	<ul style="list-style-type: none"> * Potential for sharp rise if market prices Fed path in 2016 	n.a.	-	M	L

Impact
H High **M** Medium **L** Low

Fed's assessment of pace of hikes

	2016	After
Inflation	<ul style="list-style-type: none"> * Firming in H1 but downside risks in H2 	<ul style="list-style-type: none"> * More clearly rising toward Fed target
Neutral rate*	<ul style="list-style-type: none"> * Kept low by growth headwinds, low potential growth 	<ul style="list-style-type: none"> * Higher as headwinds fade, productivity growth rises
Financial conditions	<ul style="list-style-type: none"> * Tightening given dollar strength, higher rates 	<ul style="list-style-type: none"> * Tightening continues but at lower rate
Other	<ul style="list-style-type: none"> * Fed committed to gradual hikes * Slow tightening to avoid recession** 	<ul style="list-style-type: none"> * After a few hikes, arguments for continuing slow less compelling
Pace of hikes	<div style="border: 1px solid black; padding: 5px; text-align: center;">Slow and gradual</div>	<div style="border: 1px solid black; padding: 5px; text-align: center;">More rapid, to ward-off inflation</div>

Notes: (*) Theoretical policy rate that keeps economy at full employment and inflation on target. A higher neutral rate requires more hikes in the same period of time. (**) At zero rates, easing options are more limited, so the Fed needs to be more cautious as it raises rates.