

Vital Signs: Treasurer Morrison is about to face a reality check

Written by The Conversation

Vital Signs is a weekly economic wrap from UNSW economics professor and Harvard PhD Richard Holden (@profholden). Vital Signs aims to contextualise weekly economic events and cut through the noise of the data affecting global economies.

This week: The US Fed meets expectations for a rate cut, Australia's unemployment rate heads upwards again, and all eyes look to the mid year budget update.

Can something that you think is almost surely going to happen still be big news when it does?

The US Federal Reserve's decision to raise its benchmark Federal Funds Rate this week looks like proof that it can be. Markets had put a 97% chance on a rise to a 0.5%-0.75% target band, up 25 basis points, at the December FOMC meeting. Had the Fed not raised rates then markets would surely have been spooked. It would have indicated that they didn't understand how the Fed thinks, and that the US economic recovery was not going as well as they thought.

In short, it was a relief.

The [official FOMC statement](#) was also unusually precise in stating the reasons for the rise:

“The labor market has continued to strengthen and that economic activity has been expanding at a moderate pace since mid-year. Job gains have been solid in recent months and the unemployment rate has declined. Household spending has been rising moderately but business fixed investment has remained soft. Inflation has increased since earlier this year but is still below the Committee's 2 percent longer-run objective, partly reflecting earlier declines in energy prices and in prices of non-energy imports.

In view of realized and expected labor market conditions and inflation, the Committee decided to

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raise the target range for the federal funds rate to $\frac{1}{2}$ to $\frac{3}{4}$ percent. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a return to 2 percent inflation.”

Translation: the labour market is getting strong enough to warrant a rise, and inflation is still pretty low. So despite the rise, interest rates are still extremely low.

At Fed Chair [Janet Yellen's press conference](#) she was asked whether the FOMC had discussed the election of Donald Trump and the impact that might have. Her response was pretty direct and very interesting.

“We did discuss these topics in our meetings...all the FOMC felt that there is considerable uncertainty about how economic policies may change...we will have to factor those policies along with many other things...into our outlook...we are operating under a cloud of uncertainty.”

“Considerable uncertainty,” eh. Well, I guess saying “who knows what Trump is going to do?” would be inappropriate.

The Fed was not going to move upwards until it was confident that it didn't need to cut rates again. So this probably marks the start of a sequence of rate rises throughout 2017. Look for as many as four or five more next year.

In Australia, unemployment rose slightly to 5.7%. Employment Minister Michaelia Cash made the seemingly-odd statement that this was “good news”. The logic behind her argument was that the labour force participation rate had gone up from 64.4% to 64.6%. 39,100 jobs were created last month, and indeed 39,300 of them were full time – along with the loss of 200 part time jobs.

I can't fault the minister's logic: more people having the confidence to look for jobs, more jobs, and all of them full time.

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I do question her politics, though. This is a small, one-month movement. Pinning oneself to a logic that could easily be reversed – even next month – is a very dangerous thing. Or, to borrow from Yes Minister, it's "courageous".

Next week Federal Treasurer Scott Morrison will deliver the Mid Year Economic and Fiscal Outlook (MYEFO). This will be closely watched by the market and credit ratings agencies alike.

The key thing to watch for is nominal GDP growth and forecasts of it. Nominal GDP drives tax receipts, and hence national debt. As [I said here on budget night](#), the forecast figures in the budget were absurdly optimistic.

At some point, forecasts become reality. And the treasurer will have to own up to that reality.

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