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Macro+Rates Strategy

US Sep FOMC: The Expected, The Good & The Missing

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- **The Expected:** FOMC, as widely expected, announced the decision to hike its policy Fed Funds Target Rate (FFTR) by another 25bps to 2.00-2.25% range while it will increase its balance sheet reduction (BSR) program to US$50bn in Oct 2018, as scheduled.

- **The Good:** Fed Reserve maintained its bullish US growth and employment outlook in its statement with a significant growth forecast upgrade in 2018 and expectations for US growth to continue at least until 2021. Unemployment rate and inflation forecasts remain largely unchanged.

- **The Missing:** The Sep FOMC statement removed the description of monetary policy as remaining "accommodative" (which had been in the FOMC statements since late 2015) without any replacement. Beyond comments from FOMC Chair Powell during the press conference, the FOMC statement again refrained from mentioning US trade policy developments and the risks it may pose to the US economy.

- There was no change in the Sep dot-plot chart (from Jun) as it continued to show 2018 FFTR median forecast at 2.4% (which implies 4 hikes), the 2019 FFTR forecast at 3.1% (implies 3 hikes in 2019) and the 2020 FFTR forecast at 3.4% (implies 1 hike in 2020). The new addition of 2021 forecast at 3.4% implies no more rate hike in 2021.

- We continue to expect a fourth hike in the remaining part of 2018 (Dec FOMC), bringing the FFTR range to 2.25%-2.50% by end-2018, followed by 3 more hikes in 2019.

- Notwithstanding the UST price action post-FOMC, we continue to expect modestly higher UST yields by end-2018, and into next year.

The Fed Reserve Affirms 4 Rate Hikes In 2018, Removes "Accommodative" & Still No Mention Of Trade Disputes In Statement

The key takeaways for the 25/26 Sep 2018 FOMC decision:

1. As widely expected, the Fed raised its policy Fed Funds Target Rate (FFTR) by another 25bps to 2.00%-2.25% range in an unanimous decision (9-0) while it will increase its balance sheet reduction (BSR) program to US$50bn (comprising US$30bn of UST and US$20bn of MBS) in Oct 2018, as scheduled.

2. The updated September dot-plot chart showed an unchanged rate hike trajectory (from June FOMC) but 14 Fed policy makers are now expecting 4 rate hikes in 2018 (up from 8 policy makers who expected 4 or more hikes in June FOMC). The 2018 FFTR median forecast was **unchanged** at 2.4% (which implies 4 hikes) as was the 2019 FFTR median forecast which stayed at 3.1% (implying 3 hikes in 2019). The 2020 median forecast was also unchanged at 3.4% (implying 1 more hike in 2020) while the 2021 median forecast is at 3.4% (implying no more hike in 2021). The long run forecast was revised marginally higher to 3.0% (from 2.9% previously in June FOMC)

3. The Fed is visibly more confident about the US economy as its latest economic projections showed a significant upgrade to 2018 GDP growth to 3.1% (from 2.8% in June FOMC) and the Fed expects growth to continue (with some moderation) at least 3 more years until 2021, the new timeframe for the Fed's projections. There was little change to the unemployment rate or inflation projections. US unemployment rate is still expected to undershoot further in 2018 (3.7%) and 2019--2020 (3.5%) before a slight increase in 2021 (3.7%), but still well below the long run unemployment rate of 4.5% while inflation will still slightly overshoot 2% during 2018-2021 (2.1%). See Table on last page.

4. The Sep FOMC statement removed the language "*The stance of monetary policy remains accommodative, thereby supporting strong labor market conditions and a sustained return to 2 percent inflation*" (which had been in the FOMC statements since late 2015) without any replacement, leading to speculation that this is a signal that monetary policy is no longer accommodative and may be moving closer to neutral rate. However, FOMC Chair Powell said (during his press conference) that the removal of the statement did not signal a policy change. (Hmmm, so what does it mean then?) It also repeated that near-term risks to the economy appear "roughly balanced" (unchanged from Jul/Aug 2018 FOMC).

5. The Fed also announced (in the implementation note) a 25bps increase in the interest on excess reserves (IOER) to 2.20% with effect from 27 Sep. This was in contrast to the smaller 20bps increase of the IOER to 1.95% implemented in the June 2018 FOMC, but it still maintains the small 5bps gap between IOER and FFTR.

6. Perhaps more notable is what remains clearly missing in the latest FOMC statement: Still no mention of the escalating trade disputes between US and China, and challenging trade negotiations between US and its allies. While the trade tension concerns were discussed in the previous FOMC minutes, the topic again did not feature in the Sep FOMC statement (just like it was missing in the Jun and Aug FOMC statements).

In additional comments made during his press conference, FOMC Chairman Powell noted that US economy is in a 'particularly bright moment' and the gradual return to normal interest rates is helping to sustain US economy with growth outlook remaining favorable, boosted by fiscal stimulus. The Fed expects inflation to remain near 2 percent on a sustained basis but does not see inflation surprising to the upside. Powell emphasized that removal of 'accommodative' in statement is a sign that monetary policy is proceeding in line with expectations and opined that monetary policy is still accommodative, as rates are still below the estimate of 'neutral'. That said, Powell admitted that it is hard to be confident that interest rates need to be above neutral level in 2020, 2021.

Powell revealed that business contacts across the country are showing rising chorus of concern about trade tensions even though the effects of trade tensions are still relatively small. He worries where trade tensions are going in the longer run and views that widespread tariffs and a more protectionist world will be bad for US and the global economy.

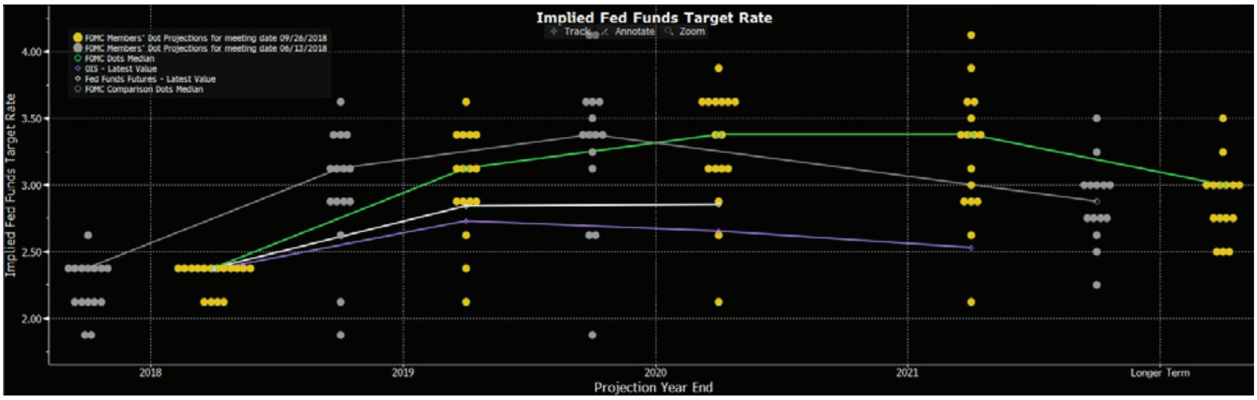
September 2018 Dot-Plot Chart Rate Projections – Unchanged Path In 2018 & 2019

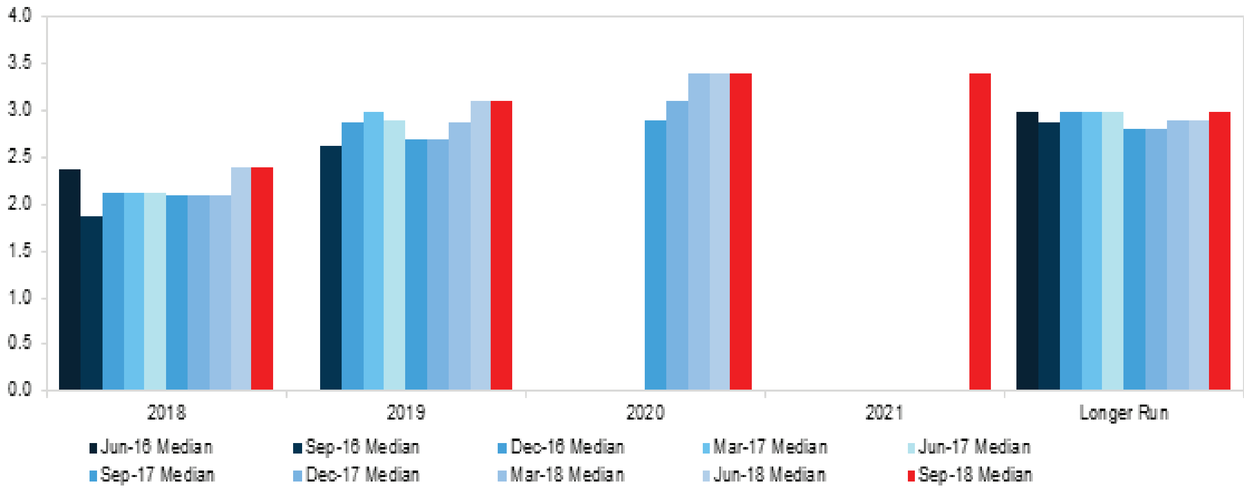
As we mentioned earlier, the September updated projected appropriate policy path based on the median expectations shown in the latest dot-plot chart was unchanged from June. It still implies 4 rate hikes in 2018 followed by 3 more hikes in 2019 and 1 more hike in 2020:

- Expect FFTR to 2.4% by end-2018 (unchanged from Jun 2018 FOMC) [**Implies 4 hikes in 2018, means 1 more hike in 4Q 2018**]
- Expect FFTR to 3.1% by end-2019 (unchanged from Jun 2018 FOMC) [**Implies 3 hikes in 2019**]
- Expect FFTR to 3.4% by end-2020 (unchanged from Jun 2018 FOMC) [**Implies 1 hike in 2020**]
- Expect FFTR to stay at 3.4% by end-2021 [**Implies no hike in 2021**]
- Longer-run interest rate forecast is marginally higher to 3.0% (from 2.9% in Jun 2018 FOMC).

Sep 2018 Vs Jun 2018 Dot Plot Chart Rate Comparison & History Of Past Projections

Source: The Federal Reserve, Bloomberg, UOB Global Economics & Markets Research (As of 26 Sep 2018)





Our FOMC Outlook – Cementing Expectations For A 4th Hike For 2018 In December

Post-FOMC, market rate hike expectations for another hike in Nov 2018 went to 0% while the chances of a December 2018 hike is at 77.5%, based on trading in futures and options data compiled by Bloomberg (WIRP) (as of 26 Sep 2018), which is above the perceived threshold of 75% (for Fed to be moving on hikes).

We maintain our Fed rate trajectory in 2018 and we continue to expect one more hike for this year (Dec 2018 FOMC) to bring the FFTR range to 2.25%-2.50% by end-2018. That said, even if the Fed hikes four times this year – which represents the fastest annual pace of normalization since the Fed started hiking rates in 2015 – we do not view it as excessive US monetary tightening, given the sweet spot that the US is in at the moment, in terms of growth, inflation and unemployment.

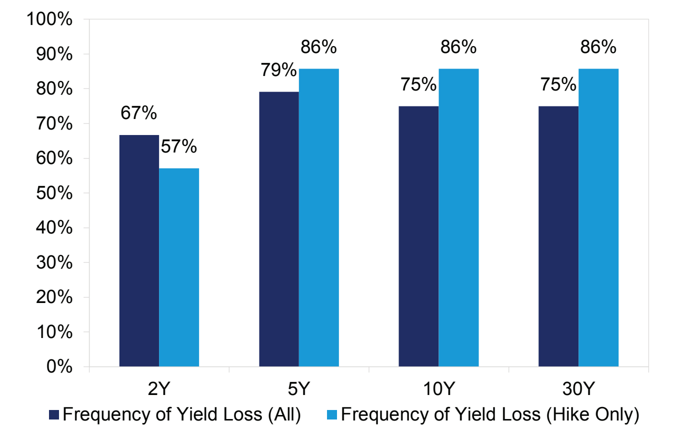
We also maintain our 2019 rate hike expectation at three 25bps hikes which now implies that we expect the Fed to exceed their long run FFTR of 3.0% by mid-2019. The Fed's balance sheet reduction (BSR) program is expected to continue as scheduled. Taking the BSR into consideration, implies the FOMC will not add more rate hikes (beyond what is implied in the dot-plot chart) unless we get a sharp inflation surprise. While we remain mindful that stronger wage and inflation expectations could add to the risk of a more aggressive Fed in terms of policy normalization, the elephant in the room is clearly the escalating US-China trade tensions which could warrant a more cautious Fed. But beyond Powell's comments, the Fed has not yet quantified any impact from the trade issues in its economic forecasts.

Despite Initial Market Reaction, We Still Expect Higher UST Yields By End-2018 & 2019

Market reaction post FOMC has been in line with historical precedents, with UST yields falling and the curve flattening. The correction comes after a month of almost persistently higher yields and has lifted the daily RSI on 10Y UST from its oversold extremes. Looking ahead, it is premature to call an end to a possible test of this year's high yield of 3.12% in the 10Y UST while the trend line from August remains in effect. After considering the latest FOMC, our forecast for 10Y UST remains for modestly higher yields in the next four quarters and for the yield curve to remain flat until we get closer to the peak of this current FED tightening cycle.

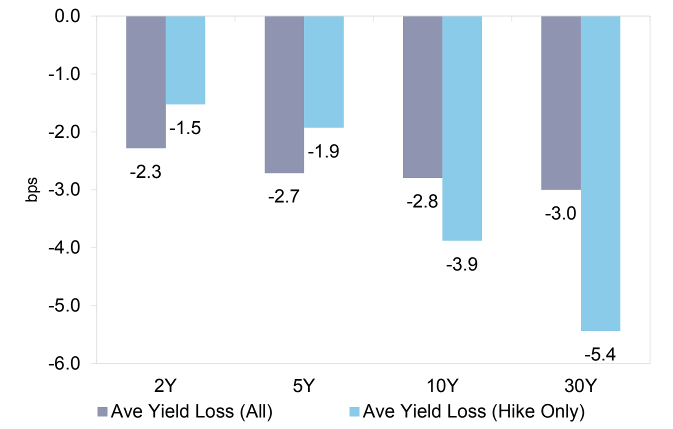
Frequency Of UST Yield Loss 5 Days After FOMC

Source: Bloomberg, UOB Global Economics & Markets Research



Average UST Yield Loss 5 Days After FOMC

Source: Bloomberg, UOB Global Economics & Markets Research



Please click on the links to access the 25/26 September 2018 FOMC statement and the September 2018 FOMC updated economic projections.

%	26 Sep	4Q18F	1Q19F	2Q19F	3Q19F	4Q19F	1Q20F	2Q20F
US Fed Funds Target	2.00-2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.50
3M USD LIBOR	2.39	2.80	2.95	3.20	3.45	3.45	3.65	3.65
10Y UST Yield	3.05	3.20	3.25	3.35	3.40	3.50	3.65	3.65

Source: UOB Global Economics & Markets Research

Economic Projections of US Federal Reserve Board, September 2018					
Variable	Central Tendency				
	2018	2019	2020	2021	Longer Run
Change in Real GDP	**3.0 - 3.2 (↑)**	**2.4 - 2.7 (↑)**	**1.8 - 2.1 (↑)**	**1.6 - 2.0**	**1.8 - 2.0 (-)**
June 2018 projection	**2.7 - 3.0 (↑)**	**2.2 - 2.6 (-)**	**1.8 - 2.0 (↓)**		**1.8 - 2.0 (-)**
March 2018 projection	2.6 - 3.0 (↑)	2.2 - 2.6 (↑)	1.8 - 2.1 (↑)		1.8 - 2.0 (↑)
Unemployment Rate	**3.7**	**3.4 - 3.6 (↑)**	**3.4 - 3.8 (↑)**	**3.5 - 4.0**	**4.3 - 4.6 (-)**
June 2018 projection	**3.6 - 3.7 (↓)**	**3.4 - 3.5 (↓)**	**3.4 - 3.7 (↓)**		**4.3 - 4.6 (↓)**
March 2018 projection	3.6 - 3.8 (↓)	3.4 - 3.7 (↓)	3.5 - 3.8 (↓)		4.3 - 4.7 (↓)
PCE Inflation	**2.0 - 2.1 (-)**	**2.0 - 2.1 (↓)**	**2.1 - 2.2 (-)**	**2.0 - 2.2**	**2.0 (-)**
June 2018 projection	**2.0 - 2.1 (↑)**	**2.0 - 2.2 (-)**	**2.1 - 2.2 (-)**		**2.0 (-)**
March 2018 projection	1.8 - 2.0 (↑)	2.0 - 2.2 (-)	2.1 - 2.2 (↑)		2.0 (-)
Core PCE Inflation	**1.9 - 2.0 (-)**	**2.0 - 2.1 (↓)**	**2.1 - 2.2 (-)**	**2.0 - 2.2**	
June 2018 projection	**1.9 - 2.0 (↑)**	**2.0 - 2.2 (-)**	**2.1 - 2.2 (-)**		
March 2018 projection	1.8 - 2.0 (↑)	2.0 - 2.2 (-)	2.1 - 2.2 (↑)		
Federal Funds Rate	**2.1 - 2.4 (-)**	**2.9 - 3.4 (-)**	**3.1 - 3.6 (-)**	**2.9 - 3.6**	**2.8 - 3.0 (-)**
June 2018 projection	**2.1 - 2.4 (-)**	**2.9 - 3.4 (↑)**	**3.1 - 3.6 (-)**		**2.8 - 3.0 (-)**
March 2018 projection	2.1 - 2.4 (↑)	2.8 - 3.4 (↑)	3.1 - 3.6 (↑)		2.8 - 3.0 (-)
	Median				
Change in Real GDP	**3.1 (↑)**	**2.5 (↑)**	**2.0 (-)**	**1.8**	**1.8 (-)**
June 2018 projection	**2.8 (↑)**	**2.4(-)**	**2.0 (-)**		**1.8 (-)**
March 2018 projection	2.7 (↑)	2.4(↑)	2.0 (-)		1.8 (-)
Unemployment Rate	**3.7 (↑)**	**3.5 (-)**	**3.5 (-)**	**3.7**	**4.5 (-)**
June 2018 projection	**3.6 (↓)**	**3.5 (↓)**	**3.5 (↓)**		**4.5 (-)**
March 2018 projection	3.8 (↓)	3.6 (↓)	3.6 (↓)		4.5 (↓)
PCE Inflation	**2.1 (-)**	**2.0 (↓)**	**2.1 (-)**	**2.1**	**2.0 (-)**
June 2018 projection	**2.1 (↑)**	**2.1 (↑)**	**2.1 (-)**		**2.0 (-)**
March 2018 projection	1.9 (-)	2.0 (-)	2.1 (↑)		2.0 (-)
Core PCE Inflation	**2.0 (-)**	**2.1 (-)**	**2.1 (-)**	**2.1**	
June 2018 projection	**2.0 (↑)**	**2.1 (-)**	**2.1 (-)**		
March 2018 projection	1.9 (-)	2.1 (↑)	2.1 (↑)		
Federal Funds Rate	**2.4 (-)**	**3.1 (-)**	**3.4 (-)**	**3.4**	**3.0 (↑)**
June 2018 projection	**2.4 (↑)**	**3.1 (↑)**	**3.4 (-)**		**2.9 (-)**
March 2018 projection	2.1 (-)	2.9 (↑)	3.4 (↑)		2.9 (↑)

Source: US Federal Reserve

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