

Macro Note

US FOMC Minutes: Divided Over Number Of Rate Hikes In 2018

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- The Dec 2017 FOMC minutes showed that most of FOMC officials backed continued gradual rate hike increases and that future rate increases will be guided by inflation outlook and fiscal stimulus.
- That said, the view on the number of hikes in 2018 (3 hikes according to the Dec 2017 Dotplot chart) is divided, with some FOMC participants wanting less but some wanting more. Another contentious subject remains to be US inflation developments.
- The fiscal stimulus has made some FOMC members adjust expectations on consumer spending, capex spending and medium term growth outlook.
- Based on trading in futures and options data compiled by Bloomberg (WIRP), market rate hike expectations for a Jan 2018 Fed hike remains unchanged at an incredibly low 0% but the probability of a March 2018 hike is visibly higher to 81.9% (as of 3 Jan 2018).
- Our moderately hawkish outlook for the Fed rate trajectory in 2018 remains intact: we expect no hike in Jan 2018 FOMC and three more 25bps hikes in 2018 (in March, June and December FOMC), bringing the FFTR to 2.25% by end-2018. We also expect continuity in Fed Reserve's balance sheet reduction (BSR) program which will go on until the Fed balance sheet is reduced to US\$2.5trillion by mid-2021. Trimming the Fed balance sheet is somewhat a 'substitute' for rate hikes, so we believe the continuation of BSR is one key factor the 2018 FOMC will take into consideration and not add more rate hikes beyond the 3 hikes.

December FOMC Minutes Signaled Divided View On US Inflation & Number of 2016 Hikes

The Dec 2017 FOMC minutes which was released on 3 Jan showed that even as *"most participants reiterated their support for continuing a gradual approach to raising the target range noting that this approach helped to balance risks to the outlook for economic activity and inflation"* but participants debated on *"several risks that, if realized, could necessitate a steeper path of increases in the target range; these risks included the possibility that inflation pressures could build unduly if output expanded well beyond its maximum sustainable level, perhaps owing to fiscal stimulus or accommodative financial market conditions."* The hawkish tint to these statements partly helped the US dollar to stem recent losses and strengthened slightly on 3 Jan while longer-term US Treasury prices firmed with yields declining slightly as the Fed officials debated whether the tax cuts would require them to change their plan for rate increases in 2018.

And even as most of FOMC officials backed continued gradual rate hike increases, a few policymakers was worried that the median projection published in December would bring too many rate hikes in 2018 while a few others said more hikes could be needed in 2018 than implied in median projection.

Inflation remained a contentious subject among the Fed officials. Policymakers generally saw medium-term inflation outlook as little changed but several were concerned that persistently weak inflation may have reduced inflation expectations. On the fiscal stimulus, many policymakers expected proposed cuts in personal taxes to boost consumer spending while the business tax changes would likely boost capital spending and might boost economy's potential over the next few years. And on the flattening of the US Treasury yield curve, FOMC policymakers generally agreed flatness of yield curve was not unusual by historical standards but some expressed concern a possible future inversion could portend economic slowdown.

Post-FOMC minutes, market rate hike expectations for a Jan 2018 Fed hike remains at an incredibly low 0% (unchanged from previous day) but the chances of a March 2018 hike is now much higher at 81.4% (from 69.1% previous day), based on trading in futures and options data compiled by Bloomberg (WIRP) (as of 3 Jan 2018), going above the perceived threshold of 75% (for Fed to be moving on hikes).

Our FOMC Outlook - Projecting 3 More Hikes In 2018 But This Year's FOMC Still Uncertain

After release of the Dec 2017 FOMC minutes, our moderately hawkish outlook for the Fed rate trajectory in 2018 remains intact. We expect the **30/31 Jan 2018 FOMC** to pass without another rate hike or change to the BSR. Thereafter, we expect three more 25bps hikes in 2018 (in March, June and December FOMC), bringing the FFTR to 2.25% by end-2018. We also expect continuity in Fed Reserve's balance sheet reduction (BSR) program.

Since BSR was implemented in Oct 2017, the effect was hardly visible but it will likely gain further traction in 2018, as cuts to reinvestment expand so the aggregate annual cuts will increase from US\$30bn in 4Q 2017 to US\$420bn in 2018 and reach steady state of US\$600bn in 2019. We expect BSR to continue until the Fed balance sheet is reduced to US\$2.5trillion by mid-2021. Trimming the Fed balance sheet is somewhat a 'substitute' for rate hikes, so we believe the continuation of BSR is a key factor the FOMC will take into consideration and not add more rate hikes beyond the 3 hikes.

Fed Governor Jerome Powell is expected to succeed current FOMC Chair Janet Yellen (who will hold her last Chair in the Jan 2018 FOMC and exit the Fed on 03 Feb 2018). Powell is currently waiting for the Senate confirmation vote, but the strong bipartisan endorsement from the Senate Banking Committee (5 Dec 2017) should imply an easy passage in his Senate confirmation. Beyond the change of FOMC chair in Feb 2018, the composition of the 2018 Federal Open Market Committee (FOMC) will change and that brings some uncertainty to 2018. When at full strength, the FOMC should consist of 7 Fed Board Governors (including the FOMC chair), the New York Fed President (permanent seat); and 4 of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis.

2018 FOMC Voting Members

FOMC Chair **Janet Yellen** – Exiting on 3 Feb 2018

Governor **Jerome Powell** – Next FOMC Chair

Governor **Lael Brainard**

Governor **Randall Quarles**

Governor and Vice Chair of Federal Reserve System – **Vacant**

Governor – **Vacant**

Governor – **Vacant** (former research director at Richmond Fed, **Marvin Goodfriend** nominated)

NY Fed President & Vice Chair of FOMC **William Dudley** – retiring in mid-2018

Cleveland Fed President **Loretta Mester** (2nd time voter, hawk),

Atlanta Fed President **Raphael Bostic** (first time voter, moderately hawkish),

San Francisco Fed President **John Williams** (3rd time FOMC voter, likely moderate hawk)

Richmond Fed President **Thomas Barkin** (no prior experience in monetary policymaking, unknown)

Please click on the links to access the [12/13 Dec 2017 FOMC minutes](#) and the [2018 FOMC calendar](#).



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