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Flash Notes

US Mar 2017 FOMC: One Hike, Two More To Go In 2017 (For Now)

- **The Fed Reserve as widely expected raised the policy FFTR by 25bps to 0.75-1.00% in March 2017 FOMC but the decision was not unanimous as Minneapolis Fed President, Neel Kashkari was the sole dissenter who preferred to keep the FFTR unchanged at 0.5-0.75%.**
- **The FOMC statement maintained positive outlook on the US economy and labor market while the more material change was the FOMC language on inflation which showed the Fed more confident of higher prices.**
- **Fed still remained silent on US fiscal outlook under the new administration and its impact on the US economy and Yellen reiterated during the press conference that it was far too early to know how fiscal policy changes will unfold.**
- **The Fed again refrained from taking any measure to reduce the size of its US$4.5trillion balance sheet.**
- **The updated March dot-plot chart kept the median forecasts of 2017 and 2018 unchanged. It still indicated three hikes in 2017 and another 3 hikes in 2018.**
- **Even as we have our first 2017 rate hike in the 14/15 March FOMC, we still maintain the forecast of 3 Fed rate hikes this year. We expect the next two hikes in June FOMC and September FOMC. One of the reasons for our hawkish Fed rate trajectory outlook in the coming years is due to Trump's likely expansionary US fiscal policies and we will watch today's (16 Mar) Trump's Budget proposal closely.**
- **Beyond the rate hike trajectory, the composition of the Federal Open Market Committee (FOMC) will change going into April 2017 as Fed Governor Daniel Tarullo will resign from the Fed with effect from 5 April.**

The First Non-December Fed Hike In Mar 2017 FOMC & Material Change To FOMC Language On Inflation; Latest Dot Plot Still Points To An Unchanged 3 Rate Hike Trajectory In 2017

The Federal Reserve as widely expected increased the Fed Funds Target Rate (FFTR) by 25bps to the range of 0.75% to 1.00% in the March 2017 FOMC. The decision was not unanimous (9-1) as Minneapolis Fed President, Neel Kashkari was the sole dissenter who preferred to keep the FFTR unchanged at 0.5-0.75%. Meanwhile, the latest Dot-plot chart showed that the median forecasts of the FFTR among the Fed policy makers was unchanged for 2017 (1.375%) and 2018 (2.125%) implying two more 25bps hikes this year followed by another 3 hikes in 2018. The median forecast of the FFTR for 2019 was adjusted slightly higher to 3% (from 2.875%), which is also the expected longer run FFTR.

The Fed kept a positive outlook on the US economy & the domestic jobs market as it noted that "*the economic activity has been expanding at a moderate pace" (unchanged from the 1 Feb FOMC) and "job gains remained solid and the unemployment rate was little changed in recent months*" (from "*Job gains remained solid and the unemployment rate stayed near its recent low*" in Feb FOMC). It remained upbeat on domestic consumption as it continued to see "*household spending has continued to rise moderately*" and more importantly, **the Fed turned a bit more positive on business fixed investment** which "*appears to have firmed somewhat*" (from "remained soft" in Feb FOMC).

Perhaps the biggest upgrade was on inflation, as the Fed looked confident of higher prices noting that "*Inflation has increased in recent quarters, moving close to the Committee's 2 percent longer-run objective*" (removed the phrase "*but is still below*" from the Feb FOMC) and "*inflation will stabilize around 2 percent over the medium term*" and adding the word "*sustained"* to the phrase "*a sustained return to 2 percent inflation.*" The Fed also said that the "*Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal*" (removed the phrase "progress towards" used in Feb FOMC).

The Fed maintained its stance about risks to the US outlook, as it continues to see near-term risks to the economic outlook "*appear roughly balanced*" and it retained the statement that the Fed "*continues to closely monitor inflation indicators and global economic and financial developments*" [unchanged from the Feb 2017, Dec 2016 and Nov 2016 FOMC]. And as expected, it again made no mention on how the US President and his fiscal policies will affect the US outlook.

The Fed also maintained that it is in no hurry to tighten monetary policy as the "*Committee expects that economic conditions will evolve in a manner that will <u>warrant gradual increases</u> in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run*." (One small change was the removal of the word "only" that was previously in the Feb FOMC in the phrase "*that will warrant <u>only</u> gradual increases*")

Another item that the Fed kept at status quo was that it is not reducing the size of its US$4.5trillion balance sheet yet as the "*The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction, and it anticipates doing so until normalization of the level of the federal funds rate is well under way. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.*" (unchanged from Feb FOMC)

In the post-FOMC meeting press conference, **FOMC Chairwoman Janet Yellen** said in raising rates today, the decision was based on economy's continued progress toward reaching our two mandates and that the rate decision does not represent a change in assessment of economic outlook. Yellen was confident that the economy continues to expand at moderate pace over next few years while the job market will continue to improve somewhat further. She also expects core inflation to move up over next couple of years.

Yellen also emphasized that Fed policy remains accommodative and that waiting too long on gradual rate hikes could mean faster rate hikes later. She also assured markets that the Fed funds rate does not have to rise much to get to a neutral stance, noting that the neutral nominal rate is currently quite low. On shrinking the Fed's balance sheet, Yellen wants confidence in economy before shrinking balance sheet. On the US fiscal outlook, Yellen maintained that it is too early to tell on the fiscal policies and she has not discussed in details regarding potential fiscal changes or mapped out possible response to fiscal changes. Yellen revealed that she met a couple of times with Treasury Secretary Mnuchin and fully expects to have strong relationship with Mnuchin. She also revealed that she has briefly met US President Trump.

Markets Finds A Dovish Fed Despite March FOMC Rate Hike, Sending US Dollar Tumbling While US Treasuries & US Stocks Recording Gains

The FOMC decision was perceived to be already well-communicated and priced into the markets and as the Fed did not signal a more aggressive trajectory, the market translated the Fed decision as a "dovish hike" sending US dollar tumbling weaker while US Treasury & US stocks & gold recording gains. The Dollar index (DXY) slipped to 100.74 on Wednesday close (15 Mar) from 101.70 the previous day. The UST 10-year yield closed at 2.2.49%, well below the previous day close of 2.60. The DJIA increased more than 0.5% to close at 20,950.1 while the broader S&P 500 index gained a bigger 0.84%. Gold spot price increased by US$17.80 (1.48%) to settle at US$1220.40.

March FOMC Keeps Growth & Inflation Forecasts Mostly Intact With Only Minor Revisions

Reflecting the updated economic forecasts of the March 2017 FOMC:

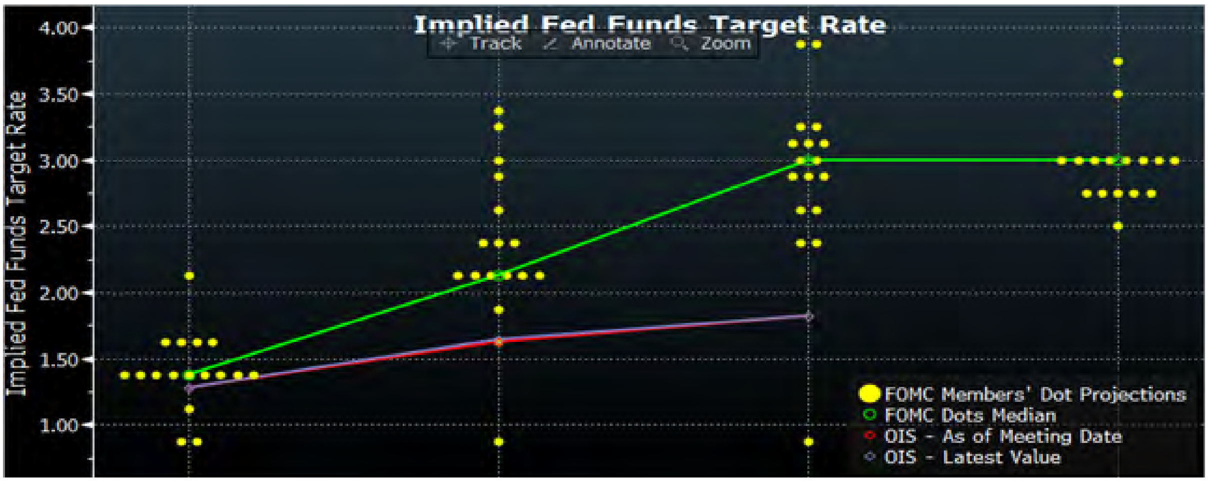
On US GDP growth,
- Revised 2017 GDP to 2.0-2.2% (from 1.9-2.3%).
- Revised 2018 GDP to 1.8-2.3% (from 1.8-2.2%).

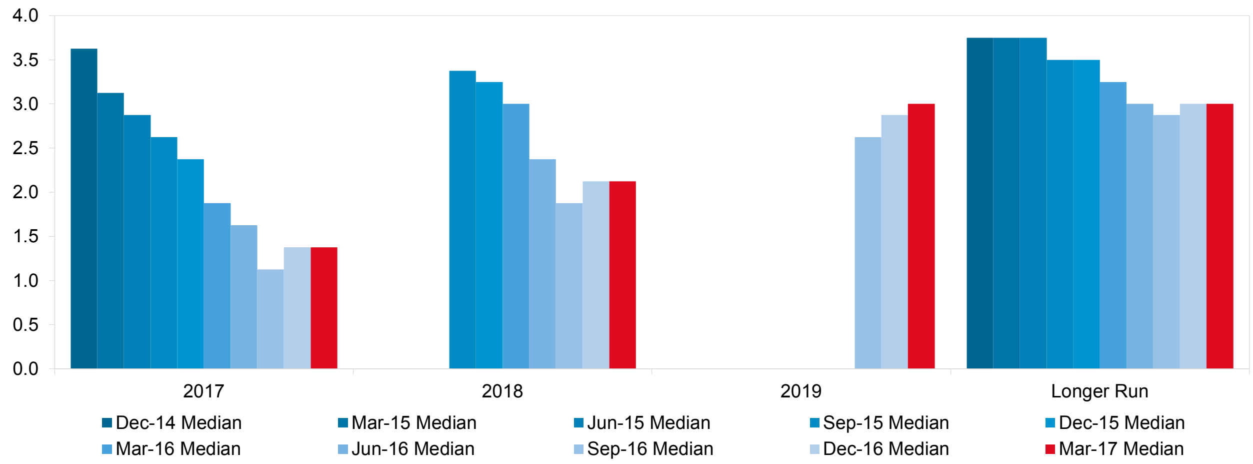
On US unemployment,
- Affirms 2017 unemployment rate unchanged at 4.5-4.6%
- Revises 2018 unemployment rate to 4.3-4.6% (from 4.3-4.7%).

On PCE inflation,
- Revises 2017 PCE inflation to 1.8-2.0% (from 1.7-2.0%).
- Affirms 2018 PCE inflation unchanged at 1.9-2.0%.

(Please see table on last page)

March 2017 Dot Plot Chart Rate Projections





Source: The Federal Reserve, Bloomberg, UOB Global Economics & Markets Research

Dot-Plot Chart Rate Projections – Median Forecasts Unchanged In 2017 & 2018

From the March 2017 dot-plot chart, the median expectations for the FFTR was maintained for 2017 and 2018 with the FOMC participants maintaining expectations for 3 hikes in 2017 and another 3 hikes in 2018:

- **Expect FFTR to 1.375% by end-2017** (unchanged from the Dec 2016 median forecast)
- **Expect FFTR to 2.125% by end-2018** (unchanged from the Dec 2016 median forecast)
- **Expect FFTR to 3.00% by end-2019** (higher than the Dec 2016 median forecast of 2.875%)
- **Longer-run interest rate forecast at 3.0%** (unchanged from the Dec 2016 median forecast).

Our FOMC Outlook – Still Looking On Course For 2 More Rate Hikes This Year

Even as we have our first 2017 rate hike in the 14/15 March FOMC, **we are still maintaining the forecast of 3 rate hikes from the Fed Reserve this year.** Against the backdrop of positive US economic data & rising US inflation together with robust US financial market performance, we expect two more 25bps rate hikes in 2017 (in the June and September FOMC of 2017), remain on pause in 4Q-2017 before resuming hiking rates in 2018 by another 4 times (in the March, June, September & December FOMC of 2018). We kept our terminal Fed Funds Target rate (FFTR) forecast unchanged at 3.5% by 4Q-2019 (which is higher than the longer run FOMC forecast of 3%). One of the main reasons for our hawkish Fed rate trajectory outlook in the coming years is due to the likely expansionary US fiscal policies from Donald Trump even as we expect the Fed Reserve to adopt a pragmatic approach towards the likely Trump fiscal boost, details of which will only gradually become available. **The immediate focus will be on Trump's Budget proposal which is scheduled to be released on Thursday (16 Mar).**

After the March FOMC, there will be no FOMC meeting in April and the **next FOMC meeting will be held on 2-3 May** (decision due on 4 May, 2am Singapore time) but it is without the updated Summary of Economic Projections or a scheduled press conference by Janet Yellen. Based on trading in futures and options data compiled by Bloomberg, the probability of another Fed rate hike in May FOMC of 2017 is at low 13.3% (as of 15 Mar) well short of the perceived threshold of 75% (for the Fed to be moving on hikes) while the June FOMC is at 50.2% probability. The Sep 2017 FOMC is the nearest decision date that has the probability of a rate hike exceeding 75%, currently at 76.9% (as of 15 Mar). That said, we have seen market sentiment can change very fast as what we just saw in the 2-3 weeks ahead of the March FOMC.

Beyond the rate hike trajectory, **the composition of the Federal Open Market Committee (FOMC) will change going into April 2017 as Fed Governor Daniel Tarullo will resign from the Fed with effect from 5 April 2017**. Tarullo is the key banking regulatory person is the leading expert at the Fed on financial regulation issues who was appointed by former US President Obama in 2009 and much of Tarullo's 8-year legacy in the Fed involves erecting banking sector safeguards after the 2007-2009 financial crisis. His term was originally set to expire in 2022 and his exit would create a 3rd open seat at the Fed Board of Governors.

The Federal Reserve Board of Governors has not had its full quota of Governors since 2013 and with Tarullo's resignation there will soon be 3 vacancies on the Fed's seven-member board. Trump has vowed to fill them soon after he assumes office but with the delays of his nominees to key cabinet appointments, it may seem that his Fed governor nominations may not get a smooth passage to confirmation by the Senate.

%	15 Mar	1Q17F	2Q17F	3Q17F	4Q17F	1Q18F	2Q18F	3Q18F	4Q18F
US Fed Funds Target	0.5-0.75	0.75-1.0	1.25	1.50	1.50	1.75	2.00	2.25	2.50
3M USD Libor	1.14	1.30	1.55	1.80	1.85	2.05	2.30	2.55	2.75
10Y UST Yield	2.49	2.50	2.75	2.80	3.00	3.00	3.25	3.25	3.50
Source: UOB Global Economics & Markets Research									

Please access the 14/15 Mar 2017 FOMC statement and economic projections of the Fed Reserve for Mar 2017.

The scheduled FOMC meetings in 2017 can be found here.

Economic Projections of US Federal Reserve Board, March 2017				
Variable	Central Tendency			
	2017	2018	2019	Longer Run
Change in Real GDP	**2.0 - 2.2 (↑)**	**1.8 - 2.3 (↑)**	**1.8 - 2.0 (-)**	**1.8 - 2.0 (-)**
December 2016 projection	**1.9 - 2.3 (↑)**	**1.8 - 2.2 (↑)**	**1.8 - 2.0 (↑)**	**1.8 - 2.0 (↑)**
September 2016 projection	1.9 - 2.2 (-)	1.8 - 2.1 (-)	1.7 - 2.0	1.7 - 2.0 (↓)
June 2016 projection	1.9 - 2.2 (↓)	1.8 - 2.1 (-)		1.8 - 2.0 (↓)
March 2016 projection	2.0 - 2.3 (-)	1.8 - 2.1 (↓)		1.8 - 2.1 (↓)
Unemployment Rate	**4.5 - 4.6 (-)**	**4.3 - 4.6 (↓)**	**4.3 - 4.7(↓)**	**4.7 - 5.0 (-)**
December 2016 projection	**4.5 - 4.6 (↓)**	**4.3 - 4.7 (↓)**	**4.3 - 4.8(↓)**	**4.7 - 5.0 (-)**
September 2016 projection	4.5 - 4.7 (-)	4.4 - 4.7 (↓)	4.4 - 4.8	4.7 - 5.0 (-)
June 2016 projection	4.5 - 4.7 (-)	4.4 - 4.8 (↓)		4.7 - 5.0 (-)
March 2016 projection	4.5 - 4.7 (↓)	4.5 - 5.0 (↓)		4.7 - 5.0 (↓)
PCE Inflation	**1.8 - 2.0 (↑)**	**1.9 - 2.0 (-)**	**2.0 - 2.1(-)**	**2.0 (-)**
December 2016 projection	**1.7 - 2.0 (↑)**	**1.9 - 2.0 (↑)**	**2.0 - 2.1(↑)**	**2.0 (-)**
September 2016 projection	1.7 - 1.9 (↓)	1.8 - 2.0 (↓)	1.9 - 2.0	2.0 (-)
June 2016 projection	1.7 - 2.0 (-)	1.9 - 2.0 (-)		2.0 (-)
March 2016 projection	1.7 - 2.0 (↓)	1.9 - 2.0 (-)		2.0 (-)
Core PCE Inflation	**1.8 - 1.9 (-)**	**1.9 - 2.0 (-)**	**2.0-2.1 (-)**	
December 2016 projection	**1.8 - 1.9 (↑)**	**1.9 - 2.0 (-)**	**2.0 (-)**	
September 2016 projection	1.7 - 1.9 (↓)	1.9 - 2.0 (-)	2.0	
June 2016 projection	1.7 - 2.0 (-)	1.9 - 2.0 (-)		
March 2016 projection	1.7 - 2.0 (-)	1.9 - 2.0 (-)		
Federal Funds Rate	**1.4 - 1.6 (↑)**	**2.1 - 2.9 (↑)**	**2.6 - 3.3 (↑)**	**2.8 - 3.0 (-)**
December 2016 projection	**1.1 - 1.6 (↓)**	**1.9 - 2.6 (↓)**	**2.4 - 3.3 (↑)**	**2.8 - 3.0 (-)**
September 2016 projection	1.1 - 1.8 (↓)	1.9 - 2.8 (↓)	2.4 - 3.0	2.8 - 3.0 (↓)
June 2016 projection	1.4 - 1.9 (↓)	2.1 - 2.9 (↓)		3.0 - 3.3 (↓)
March 2016 projection	1.6 - 2.4 (↓)	2.5 - 3.3 (↓)		3.0 - 3.5 (↓)
	Median			
Federal Funds Rate	**1.4(-)**	**2.1 (-)**	**3.0 (↑)**	**3.0 (-)**
December 2016 projection	**1.4(↑)**	**2.1 (↑)**	**2.9 (↑)**	**3.0 (↑)**
September 2016 projection	1.1 (↓)	1.9 (↓)	2.6	2.9 (↓)
June 2016 projection	1.6 (↓)	2.4 (↓)		3.0 (↓)
March 2016 projection	1.9 (↓)	3.0 (↓)		3.3 (↓)

Source: US Federal Reserve