

Fed sings the same old song

- Fed holds rates, signals hike to come, but not yet
- Cuts 2017 dots to 1.125% from 1.625%, 2018 to 1.875% from 2.375%, longer-term to 2.875% from 3.0%
- Back in June, six members saw just one hike this year, nine saw two hikes, one saw three and one saw four. With just two meetings left, there is obviously a smaller spread of views, but still no unanimity for 2016
- Fed cuts 2016 GDP forecast to 1.7-1.9 from 1.9-2.0; 2017 and 2018 left unchanged
- Core PCE, as ever, is expected to rise gradually towards target at the end of the forecast horizon
- Dovish signal from dots, but Yellen wants to convey message that the economy can withstand rate rises

As widely expected, the US Federal Reserve held rates steady at today's FOMC meeting. In a further sign of its continued difficulty in signalling to financial markets, there is still no unanimity about the last two meetings in 2016 - even though one of them comes just 6 days before the Presidential Elections on November 8th. Whilst forecasts for GDP, unemployment and inflation were little changed from the June meeting, the 'dot point medians' for 2017 and 2018 were lowered by 50bp, with a 12bp reduction for the longer run. The Fed is clearly wrestling with what the impact of demographics, productivity and structural change will be on the long-term 'equilibrium' rate of interest but its thinking will necessarily evolve incrementally, not dramatically.

The latest economic projections show GDP a tenth or so lower in 2016 but unchanged in '17 and '18. The unemployment rate, too, is barely changed from the June numbers. Core PCE inflation is expected, as usual, to reach target at the end of the forecast horizon despite a lower '16.

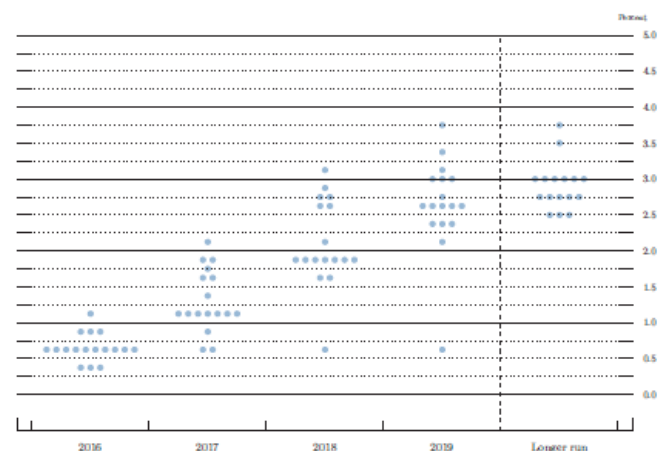
Economic Projections of Federal Reserve Board

	Central tendency			
	2016	2017	2018	Longer run
Change in real GDP	1.7 to 1.9	1.9 to 2.2	1.8 to 2.1	1.8 to 2.0
<i>June Projection</i>	1.9 to 2.0	1.9 to 2.2	1.8 to 2.1	1.8 to 2.0
Unemployment rate	4.7 to 4.9	4.5 to 4.7	4.4 to 4.7	4.7 to 5.0
<i>June Projection</i>	4.6 to 4.8	4.5 to 4.7	4.4 to 4.8	4.7 to 5.0
PCE Inflation	1.2 to 1.4	1.7 to 2.0	1.8 to 2.0	2.0
<i>June Projection</i>	1.3 to 1.7	1.7 to 2.0	1.9 to 2.0	2.0
Core PCE Inflation	1.6 to 1.8	1.7 to 1.9	1.9 to 2.0	
<i>June Projection</i>	1.6 to 1.8	1.7 to 2.0	1.9 to 2.0	

Source: Federal Reserve

The Fed cut 2017 median dot point projections from 1.625% to 1.125% and 2018 from 2.375% to 1.875%; effectively removing two of the rate hikes which had been pencilled in. The longer-run forecast was also lowered by 12.5bp to 2.875%. In another demonstration of the spread of views on the Committee, we'd note that the high-low range for the longer-run has widened to 125bp (from 2.50% to 3.75%), even as the median has moved gradually lower over time.

FOMC 'dot point' assessments



Source: Federal Reserve

The Statement notes that, "the Committee decided to maintain the target range for the federal funds rate at 1/4 to 1/2 percent. The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives." Unusually, and for the first time since late 2014, there were three dissenting members: Esther L. George, Loretta J. Mester, and Eric Rosengren, each of whom preferred at this meeting to raise the target range for the federal funds rate to 1/2 to 3/4 percent.

In her press conference, Chair Yellen noted that the current stance of monetary policy is only moderately accommodative therefore only small increases in the Fed Funds rates are needed to get back to neutral. Pressed by journalists to define "for the time being", she said that, "the economy might have a little more room to run than previously thought" and that though she and her colleagues "exchanged views" on timing, they are going to wait for more evidence which - if it materialises as expected - will lead to a rise in interest rates later this year. Arguably this is as close as we get to formal and definitive guidance.

Author:

Nick Parsons, Head of Research UK & Europe, Global Co-Head FX Research

Despite Dr. Yellen's attempts to show consensus and display a sense of calm, it does seem that the Fed is more split than at any point in the recent past. Three public dissenters wanted an immediate hike in rates whilst the high-low spread of longer term dot points is actually higher than it was at the June meeting; 125bp against 100bp three months ago. Rather than a straightforward "hawkish no-change", we have instead a messy split with 50bp taken off the dot points for 2017 and 2018 despite the more upbeat language on the economy. The attempts to paper over the cracks will likely leave investors in a state of understandable confusion about the medium-term outlook for monetary policy as we await fresh incoming data.

FOMC Statement:

Information received since the Federal Open Market Committee met in July indicates that the labor market has continued to strengthen and growth of economic activity has picked up from the modest pace seen in the first half of this year. Although the unemployment rate is little changed in recent months, job gains have been solid, on average. Household spending has been growing strongly but business fixed investment has remained soft. Inflation has continued to run below the Committee's 2 percent longer-run objective, partly reflecting earlier declines in energy prices and in prices of non-energy imports. Market-based measures of inflation compensation remain low; most survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace and labor market conditions will strengthen somewhat further. Inflation is expected to remain low in the near term, in part because of earlier declines in energy prices, but to rise to 2 percent over the medium term as the transitory effects of past declines in energy and import prices dissipate and the labor market strengthens further. Near-term risks to the economic outlook appear roughly balanced. The Committee continues to closely monitor inflation indicators and global economic and financial developments.

Against this backdrop, the Committee decided to maintain the target range for the federal funds rate at 1/4 to 1/2 percent. The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives. The stance of monetary policy remains accommodative, thereby supporting further improvement in labor market conditions and a return to 2 percent inflation.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. In light of the current shortfall of inflation from 2 percent, the Committee will carefully monitor actual and expected progress toward its inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases 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. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.

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.

Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; James Bullard; Stanley Fischer; Jerome H. Powell; and Daniel K. Tarullo. Voting against the action were: Esther L. George, Loretta J. Mester, and Eric Rosengren, each of whom preferred at this meeting to raise the target range for the federal funds rate to 1/2 to 3/4 percent.

Contact Details

FX Strategy

Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848
ray.attrill@nab.com.au

Rodrigo Catril
Currency Strategist
+61 2 9293 7109
rodrigo.h.catril@nab.com.au

Jason Wong
Currency Strategist
+64 4 924 7652
jason_k_wong@bnz.co.nz

Christy Tan
Head of Markets Strategy/Research, Asia
+852 2822 5350
christy.tan@nabasia.com

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055
julian.wee@nabasia.com

Nick Parsons
Head of Research, UK/Europe, and Global Co-Head of FX Strategy
+44 207 710 2993
nick.parsons@eu.nabgroup.com

Gavin Friend
Senior Markets Strategist
+44 207 710 1588
gavin.friend@eu.nabgroup.com

Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406
peter.jolly@nab.com.au

Group Economics

Alan Oster
Chief Economist
+61 3 8634 2927
alan_oster@national.com.au

Important Notice

This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances. NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.

Please click [here](#) to view our disclaimer and terms of use.