MARKET ANALYSIS

Ad-hoc research into market moving events from our in-house analysts



FOMC SEPTEMBER 2017 MEETING PREVIEW

- **FOMC likely to maintain rates between 1.00-1.25%; there will be focus on whether it flattens the rate hike trajectory**
- **The formal announcement of balance sheet reduction is expected; it's unclear what size the Fed wants to return it to**
- **Growth and unemployment projections unlikely to see major changes; inflation may be trimmed again**
- **Read the most recent Fedspeak** here
- **Read previews from the major bank desks** here

RATES

- Money markets price a very slim chance that the FOMC will hike rates this week, with an overwhelming 98.6% implied probability that the Federal Funds Rate target will remain between 1.00% to 1.25%. Looking ahead, markets now assign a 58% chance that rates will be lifted again in 2017.

- Federal Funds futures currently price in just two more hikes over the Fed's current forecast horizon; the FOMC's June forecasts pencilled in seven rate rises over that timeframe. Note, this week's forecast will extend the horizon out to 2020.

- Given the cautious tone of comments from FOMC participants in recent weeks, it will be interesting to see whether the central bank lowers its trajectory for the rate path down, in line with the market's view. However, analysts at Barclays do not expect a major revision to the median view of the rate profile, but sees the average falling: "We expect the median policy path to remain unchanged, but the average policy path should decline. We believe the average funds rate will decline by 15-25bp across the forecast horizon, and we believe as many as seven participants may signal that they prefer no further rate hikes this year (against nine participants who view one or more as appropriate)."

BALANCE SHEET

- It is an almost a forgone conclusion that the FOMC will formally announce the start of its balance sheet programme; indeed, 'several' were ready to make the announcement in July. The Fed has also been given some leeway not that the debt ceiling has been extended until December.

- In June, the FOMC suggested a plan where it will allow $6bln of maturing Treasuries and $4bln of maturing MBS to roll-off per month for a three-month period; that amount would then be raised to $12bln for Treasuries and $8bln for MBS for another three months, and after a year, redemptions would be capped at $30bln for Treasuries and $20bln for MBS per month.

- The plan ensures the Fed wouldn't have to outright sell any of its holdings immediately, which would cause a market reaction. In fact, Fed commentary suggests that the central bank wants to avoid any "shock and awe"; Loretta Mester (non-voter) said the intention is to set the policy, then "forget it", suggesting that balance sheet would not be an active policy tool.

- Some questions remain unanswered; for instance, what size the FOMC is ultimately seeking to cut the balance sheet to. It is currently around $4.5trln; pre-crisis, it was around $800bln, but it is unlikely that the Fed intends to bring it down to that size. It seems as though the FOMC is still undecided: William Dudley (NY Fed, permanent voter) sees the balance sheet falling to between $2.4trln and $3.5trln – a wide range, but there doesn't seem to be any firm consensus as yet.

STAFF ECONOMIC PROJECTIONS

- The Fed meets amid an improving tone in US economic data: The labour market has been ticking along nicely for some time, with the rate of joblessness beneath the Fed's estimate of NAIRU. The second estimate of growth in Q2 was revised higher to 3.0%, well above the Fed's longer-term view between 1.8% and 2.0%. Inflation has been the Achilles heel, but there are some signs of improvement here too. Recent CPI data showed upside surprises to headline and core rates; but the Fed's preferred measure – core personal consumption expenditures – lingers at the lowest since Q4 2015 at (1.4% vs Fed's June forecast of 1.7% in 2017); additionally, wage growth continues to disappoint, which may give the Fed ammunition to remain dovish.

- Analysts at Oxford Economics say "a key focus will be on the FOMC's view of recent inflation readings and its degree of conviction about whether inflation will hit the 2% target over the medium-term," adding "this in turn will underpin the committee's decision about raising rates further this year and the pace of rate increases next year." FOMC Chair Janet Yellen has previously attributed the weak inflation to temporary factors and called for patience. Many will look out for commentary on whether the Committee has reached a consensus on the extent to which low inflation is transitory, and how much patience should be extended. The likes of Neel Kashkari (voter, dovish) expressed outright concerns on inflation, whereas centrists like William Dudley see a return to target in the medium-term; others, like Robert Kaplan (voter) want to see more evidence before committing to a tighter monetary policy path.

- It is worth noting that the Fed's forecast horizon will be extended out to 2020, and the FOMC's June forecasts and the current market view are generally in line, with the exception of inflation, suggesting growth and unemployment forecasts will be little changed, though its short-term inflation views may be cut.

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Fed June 2017 Projections vs Current Analyst Consensus:

Change in real GDP:	2017	2018	2019	Longer-run
FOMC June'17 Forecasts	2.20%	2.10%	1.90%	1.80%
Analyst Consensus	2.20%	2.30%	2.00%	--

Unemployment Rate:	2017	2018	2019	Longer-run
FOMC June'17 Forecasts	4.30%	4.20%	4.20%	4.60%
Analyst Consensus	4.40%	4.20%	4.20%	--

PCE Inflation	2017	2018	2019	Longer-run
FOMC June'17 Forecasts	1.60%	2.00%	2.00%	2.00%
Analyst Consensus	1.70%	1.80%	2.00%	--

Core PCE Inflation	2017	2018	2019	Longer-run
FOMC June'17 Forecasts	1.70%	2.00%	2.00%	--
Analyst Consensus	1.60%	1.80%	1.90%	--

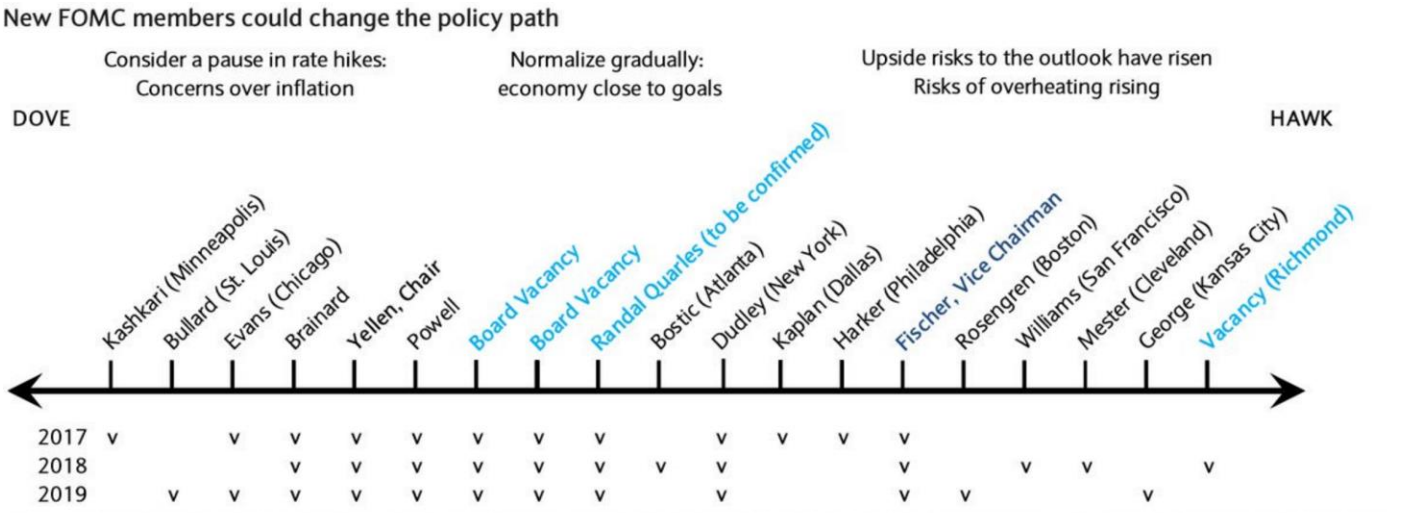
Source: FOMC, Reuters, RANsquawk

PRESS CONFERENCE WITH CHAIR YELLEN

- Chair Janet Yellen will likely adopt her usual balanced approach in her press conference, according to SGH Macro Advisors, to ensure that the FOMC still has the option of a rate hike in 2017. “She will certainly give voice to dovish concerns over the persistence in low inflation and the possibility of a new inflation dynamic emerging,” SGH says, “but on balance, we still expect her to modestly tilt her remarks to a base rate path that would warrant a possible third-rate hike in December.”

- In addition to inflation, the Fed’s forecasts, and the immediacy of near-term rates hikes, Yellen may also be quizzed on FOMC personnel following the early resignation of Stanley Fischer. Tradition dictates that outgoing Governors do not usually attend the last meeting of their term; however, the Fed has confirmed that Fischer will be in attendance, though it is unclear whether he will be submitting economic forecasts.

- The upshot of Fischer’s resignation means that there would be four vacancies on the Fed’s Board of Governors; but additionally, there remains doubt around Chair Yellen’s own position when her term expires next year, and on top of that, the position of President of the Richmond Fed (which will have a vote in 2018) remains unfilled.



Notes: Blue denotes vacancies, "v" signifies voting member. Randal Quarles has been nominated to the Board of Governors and for Vice Chair of Supervision. Vice Chair Fischer resigned effective mid October. Mark L. Mullinix is interim president and chief operating officer of the Federal Reserve Bank of Richmond. He assumed the responsibilities of interim president on April 4, 2017. The Trump administration is reportedly considering Marvin Goodfriend for appointment but no official nomination has been made. Goodfriend was former director of research at the Richmond Fed. Source: Barclays Research

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