MARKET ANALYSIS

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FOMC Meeting Minutes Preview (Oct/Nov 2017)

- **The FOMC Oct/Nov meeting minutes will be released on 22 November 2017 at 1900 GMT / 1400 EST**
- **The meeting was a non-event; rates were kept on hold, though it did upgrade its view of US economic progress**
- **Nothing is expected in the minutes to alter the December rate hike narrative, and a 'gradual' hike trajectory**

The FOMC's Oct/Nov meeting was uneventful, with the central bank holding rates between 1.00% and 1.25% in a unanimous vote, as was widely expected. There was no press conference with chair Yellen, nor were there any new forecasts (both due at the 12-13 December meeting).

The only real tweak was its small upgrade in the language used to describe the US economy, which is now seen to be expanding at a "solid rate" (versus the previous "rising moderately"), despite the disruptions caused by the recent hurricanes.

December Hike Narrative:

Analysts concluded that there was nothing in the statement to suggest that, absent any major shocks, a December rate hike is merely a formality, given the recent comments from Fed speakers. According to the CME's Fedwatch Tool, a December hike is fully priced.

"In recent weeks," HSBC says, "many Fed policymakers have said that they are watching inflation closely. Even so, a number of these officials have expressed the view that they would likely be willing to support a rate hike in December."

Inflation:

At the Oct/Nov meeting, the Committee pushed its familiar line that inflation was seen below target in the near-term, but does expect stabilisation in the medium-term. The latest batch of US CPI data endorses that thesis, though does offer some reasons for optimism.

In October, CPI Y/Y fell by 0.2ppts to 2.0%, largely on the back of energy prices. However, core inflation rose for the first time since January, by 0.1ppts to 1.8% Y/Y, and on a three-month annualised measure, is now running at 2.4% as some of the temporary factors that weighed on core inflation seems to be abating.

"Fundamentally, there are still good reasons to expect core inflation to trend higher next year," writes Capital Economics. "The depreciation in the dollar this year should feed through to stronger goods price inflation, and the upward trend in producer price inflation shows that domestic price pressures are building. Finally, the tightening of the labour market should put some upward pressure on wage growth."

Balance Sheet Normalisation:

While not much is expected by way of fresh news that may help markets re-price the Fed's hike trajectory, there will be focus on comments relating to balance sheet normalisation.

"The November statement had little new to say about the balance sheet normalisation programme initiated by the Fed in October," HSBC says, "However, the minutes of the meeting are likely to show some discussion by the Fed staff and policymakers regarding how the programme is proceeding so far."

WHAT BANK DESKS ARE SAYING:

BARCLAYS: The only real surprise in the November FOMC statement was the upgrade of the assessment of economic activity relative to prior months. Outside of that modest alteration, the remainder of the statement was in line with our expectation. We believe there is a consensus within the committee for a third rate hike this year in December and look for the minutes to provide confirmation of this intended action. That said, we also believe there is willingness by some committee members to pause and assess where inflation trends are before signalling confidence about the appropriate policy path next year. Hence, we expect language that expresses concern about recent inflation trends and whether disinflation this year is persistent or transitory in nature.

CAPITAL ECONOMICS: The Fed was never expected to raise interest rates at its November meeting and so the minutes will be pored over for any insights on the likelihood of a December rate hike. November's FOMC statement did note that core inflation "remained soft". If anything, however, the statement was more hawkish because it characterised economic growth as "solid" rather than the usual "moderate". In terms of Fed language, the progression is usually "modest", "moderate" then

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"solid". The FOMC previously described consumption and investment growth as "solid" in December 2015, when it first raised interest rates from near-zero and over the past couple of years, job gains have regularly been described as "solid". Economic growth hadn't been described as solid since 2014, which is the last time when GDP growth recorded back-to-back 3% annualised gains. Recall that at the September meeting, 12 of 16 officials thought there should be at least one more rate hike before the end of this year. Since then, the centrist Vice Chair Stanley Fischer has departed and the more hawkish Randal Quarles has been added to the FOMC. Our guess is that the recent incoming data won't have changed those views substantially. Real activity and employment growth have been strong, while core inflation has shown signs of bouncing back. The meeting at the start of this month also preceded the announcement of Jerome Powell's nomination to be the next Fed Chair when Janet Yellen's term ends early next year. We wouldn't expect the minutes to acknowledge the move, not least because it wasn't formally announced until the next day.

CREDIT AGRICOLE: Minutes should be uneventful and focus on familiar themes We think the FOMC minutes from the 1 November meeting will touch on some well-established themes from the past three months. The minutes will be monitored for the strength of views held by those who want to see further progress on inflation moving towards the 2% objective before tightening monetary policy much more. Presidents Bullard, Evans, Kashkari and Governor Branaird likely fall into this group. Others on the committee have put more emphasis on tightening resource constraints, notably unemployment below the natural rate and potential risks from low rates as investors reach for yield and drive up asset prices. This group favors continuing with gradual rate hikes. We don't expect that the minutes will change market expectations for a December rate hike, currently fully priced in the OIS-market. We will be looking for any signs of possible dissents (Kashakari?) at the December meeting. We do not believe that the minutes of the meeting discussion will delve much into the economic impact of tax changes in Washington. Given the lack of any details on 1 November, such a discussion would have been premature. However, those that favor continued tightening might believe that the potential for a deficit-financed fiscal stimulus could add to inflationary pressures down the road given estimates of potential growth and generally tight labor market conditions.

DB: While we do not expect anything in the minutes to dissuade market participants from assigning a high likelihood of a December rate hike, several Fed officials, including 2018 FOMC voters Bostic, Mester, and Williams have signalled an openness to rethinking the Fed's broader operating framework. In turn, we would not be surprised to see officials beginning to discuss potentially major changes to elements of its operating framework that could include the inflation target or other related strategies such as price level targeting. Former Fed chair Bernanke has also recently weighed in on this topic, arguing in favor of temporary price level targeting if the fed funds rate hits the effective lower bound in the future. While Chair Yellen's appearance on Tuesday evening at NYU Stern Business School is being billed as a conversation with Mervyn King, the debate around inflation targeting, which has been the mantra of most central banks for the last several decades, could be a notable feature of the discussion.

HSBC: We do not expect any major surprises to come from the minutes of the 31 October to 1 November meeting. The policy statement released in November described economic activity as "solid", despite the recent hurricanes. In addition, the statement noted that inflation was expected to remain below 2% in the near term but to stabilise around the 2% target over the medium term. In recent weeks, many Fed policymakers have said that they are watching inflation closely. Even so, a number of these officials have expressed the view that they would likely be willing to support a rate hike in December. The November statement had little new to say about the balance sheet normalisation programme initiated by the Fed in October. However, the minutes of the meeting are likely to show some discussion by the Fed staff and policymakers regarding how the programme is proceeding so far.

ING: The FOMC minutes (Wed) will continue to allude to diverging views within the committee and is unlikely inspire much upside in US rates or the USD this week. Nonetheless, we expect the markets' Fed-obsession to come to a halt in 2018 as monetary policy re-pricing opportunities look to be greater elsewhere.

MORGAN STANLEY: The FOMC minutes are often revised nearly all the way up until the release and can be edited to stress important points. We look for the Fed to resume its gradual path of rate hikes again in December.

RBC: FOMC Meeting Minutes (Wed): We don't expect any significant news from the minutes of the November 1st FOMC meeting, which is fortunate because most market participants will be busy baking pumpkin pies when it is released at 2pm on Wednesday. There will be a brief discussion of the impact of the hurricanes, but the statement already indicated that the FOMC believes "the storms are unlikely to materially alter the course of the national economy over the medium term". There is also a very slim chance that the FOMC begins to discuss the ultimate size of the Fed balance sheet (short answer: unless you know the LCR rules in the future and the relative spread between IOER and short Treasuries, you can't know the ultimate size of the balance sheet).

TD SECURITIES: Markets all but fully expect a Dec rate hike, with around 1.5 hikes priced for 2018. Thus we expect the market to largely look past debates around Dec in the Nov FOMC minutes as old news. The bigger question is whether they give any signal about the path for rates next year. Our base case is that there won't be enough clarity in the discussion to suggest clear changes to the Dec dot plot.