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FOMC Meeting

Expected rate hike with plan to unwind balance sheet

16 June 2017

MACRO | FED | MONETARY POLICY

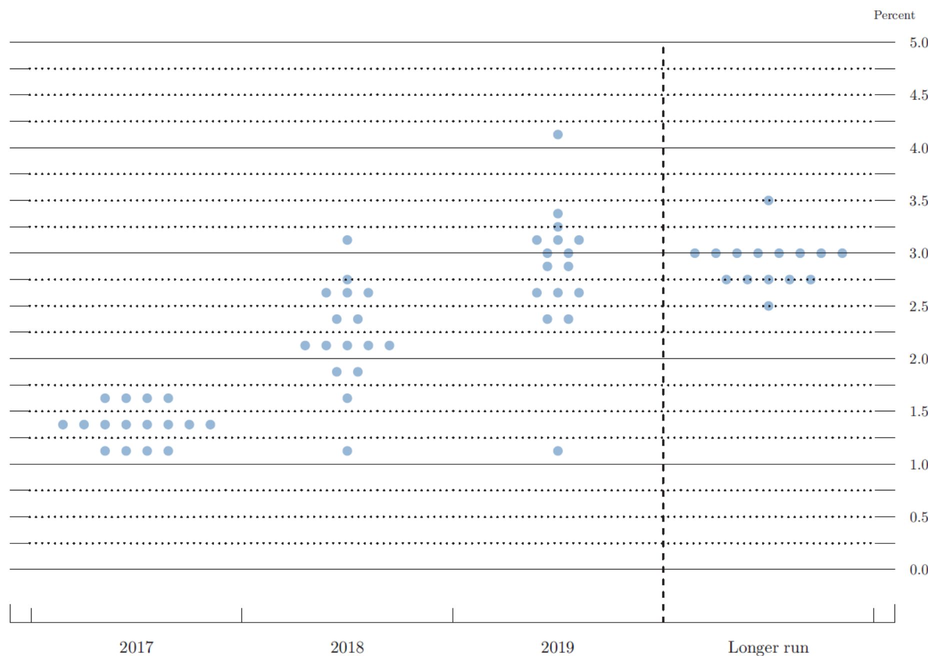
1. Federal funds rate increased to 1.25 percent

The Federal Open Market Committee has raised its benchmark rates by 0.25 percent, to between 1 percent and 1.25 percent. This is in line with market expectation. However, the main focus of the 14 June FOMC meeting was on the trajectory of the rate hikes and the plan of the winding down of the FED balance sheet.

2. One remaining hike in 2017 and three more in 2018

Looking at the dot plot of the expectation of the fed targeted funds rate, median expectation of the rate for 2017 is at 1.25% - 1.50%. This would suggest another rate hike before the end of 2017. In addition, we should be expecting 3 more rate hikes in 2018 to reach the median expectation of 2.0% - 2.25%.

Fig 1: Median expectation of funds rate indicates one more rate hike for 2017



Source: FOMC Economic Projection

3. Exit strategy of the Fed balance sheet

The plan for the unwinding the Fed balance sheet (or the reversal of QE) was finally laid out in black and white.

For U.S. Treasuries
Trimming reinvestment in Treasuries with a cap of US$6bn per month for a period of 3 months before increasing the cap in steps of US$6bn at three-month intervals over a period of 12 months until it reaches US$30bn per month.

For Mortgage-backed securities (MBS)
Trimming reinvestment in agency debt and MBS with a cap of US$4bn per month for a period of 3 months before increasing the cap in steps of US$4bn at three-month intervals over a period of 12 months until it reaches US$20bn per month.

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In aggregate, the Fed expect to trim US$10bn per month off their balance sheet initially and build up to US$50bn per month by the end of 12 months.

However, the plan came with a caveat.

"Provided that the economy evolves broadly as anticipated", as stated in FOMC statement.

After the implementation of the normalisation of the balance sheet, it is anticipated that the balance sheet of the Fed will be at a level appreciably below that seen in recent years but larger than before the financial crisis.

4. Fed lower inflation expectation for 2017

Inflation will be a key concern in the months to come as inflation data fell short of expectations over the past three consecutive months. As such, the FOMC's inflation forecast for 2017 was lower.

PCE inflation was revised down to 1.6% from 1.9% while PCE core inflation was revised down to 1.7% from 1.9%.

Our thoughts on the tightening monetary policies

On the back of a series of weakening economic data release, we felt that it was not the optimal time for Janet Yellen and co. to announce their normalisation plan for the Fed balance sheet. Retail sales and inflation data which were released earlier on the same day, clearly show some sign of weakness.

Fig 2: Retail sales falling

Fig 3: Inflation not picking up as expected

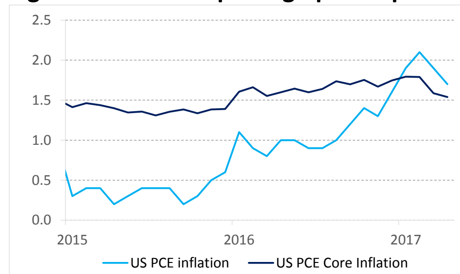
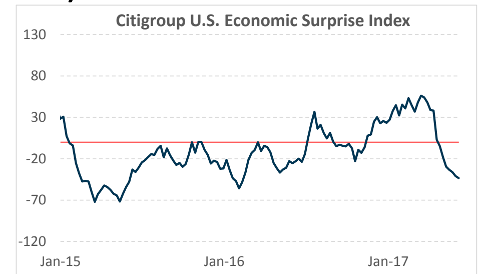


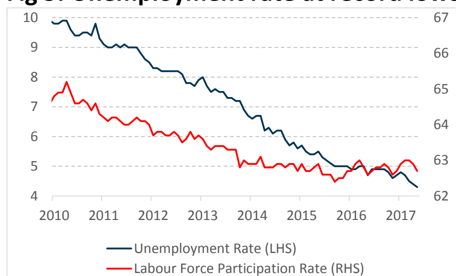
Fig 4: Citi US macro surprise index drop to 2 years low



Source: CEIC, PSR

However, the labour data have been solid and might prove to be the catalyst for the Fed to follow through with their plan to normalise their balance sheet. The unemployment rate is at record low.

Fig 5: Unemployment rate at record lows



In conclusion, we felt that there were no strong reasons for the FOMC to delay the normalisation of the Fed balance sheet. Inflation will be a key data to watch out for in the coming months as further weakness in inflation may potential stall the normalisation plan of the FOMC.

Changes in the FOMC Statements from May 2017 to June 2017

May 2017	June 2017	Comments
Information received since the Federal Open Market Committee met in *March* indicates that the labor market has continued to strengthen *even as growth in economic activity slowed.*	Information received since the Federal Open Market Committee met in *May* indicates that the labor market has continued to strengthen *and that economic activity has been rising moderately so far this year.*	More upbeat on economic growth
Job gains were solid, on average, in recent months, and the unemployment rate declined.	*Job gains have moderated but have been solid, on average, since the beginning of the year,* and the unemployment rate *has* declined.	Weaker tone on labour condition
Household spending rose only modestly, but the fundamentals underpinning the continued growth of consumption remained solid. Business fixed investment firmed.	*Household spending has picked up in recent months, and business fixed investment has continued to expand.*	Shades up household spending and business fixed investment
Inflation measured on a 12-month basis recently *has been running close to the Committee's 2 percent longer-run objective.* Excluding energy and food, consumer prices declined in March and inflation continued to run somewhat below 2 percent.	On a 12-month basis, inflation has *declined recently* and, like the measure excluding food and energy prices, is running somewhat below 2 percent.	Less optimism on the inflation
Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.	Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.	No Change
Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability.	Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability.	No Change
The Committee *views the slowing in growth during the first quarter as likely to be transitory and* continues to expect that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace, labor market conditions will strengthen somewhat further, *and* inflation will stabilize around 2 percent over the medium term.	The Committee continues to expect 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 on a 12-month basis is expected to remain somewhat below 2 percent in the near term but to* stabilize around the Committee's 2 percent objective over the medium term.	Inflation down, growth up
Near-term risks to the economic outlook appear roughly balanced. The Committee continues to closely monitor inflation indicators *and global economic and financial developments.*	Near term risks to the economic outlook appear roughly balanced, but the Committee is monitoring inflation developments *closely.*	Inflation remains key, no longer looking at the rest of the world.
In view of realized and expected labor market conditions and inflation, the Committee decided to maintain the target range for the federal funds rate at *3/4 to 1* percent.	In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to *1 to 1-1/4* percent.	Raises the Fed funds target range by 25 bps
The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2 percent inflation.	The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2 percent inflation.	No Change

Changes in the FOMC Statements from May 2017 to June 2017

May 2017	June 2017	Comments
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.	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.	No Change
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.	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.	No Change
The Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal.	The Committee will carefully monitor actual and expected inflation developments relative to its symmetric inflation goal.	No Change
The Committee expects that economic conditions will evolve in a manner that will warrant 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.	The Committee expects that economic conditions will evolve in a manner that will warrant 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.	No Change
However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.	However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.	No Change
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,	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.	No Change
and it anticipates doing so until normalization of the level of the federal funds rate is well under way.	The Committee currently expects to begin implementing a balance sheet normalization program this year, provided that the economy evolves broadly as anticipated.	Mention of normalisation of balance sheet
This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.	*This program, which would gradually reduce the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities, is described in the accompanying addendum to the Committee's Policy Normalization Principles and Plans.*	Program include letting securities mature and not rollover. Additional information on plans to normalise balance sheet in the addendum.
Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Charles L. Evans; Stanley Fischer; Patrick Harker; Robert S. Kaplan; *Neel Kashkari;* and Jerome H. Powell.	Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; Charles L. Evans; Stanley Fischer; Patrick Harker; Robert S. Kaplan; and Jerome H. Powell.	All but one follow through on the idea that tightening is needed.
	Voting against the action was Neel Kashkari, who preferred at this meeting to maintain the existing target range for the federal funds rate.	Maybe Kashkari notes the flattening yield curve.

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