

FOMC Review

Fed kept its flexibility but June hike still seems unlikely

Fed removes the word 'risk' from the statement

As expected, the Fed maintained the target range at 0.25-0.50%. As there was no press conference or updated projections, focus was on the statement. **In contrast to our expectation, the Fed removed 'global economic and financial developments continue to pose risks'**, which was included in the statement in March. Now the Fed **'closely monitors inflation indicators and global economic and financial developments'**. In other words, it acknowledges that financial stress has eased and China has stabilised by removing the word 'risks'. Still, the statement was only slightly more hawkish than in March, as the Fed did not state something similar to *'risks are nearly balanced'* – the Fed is still worried, just not as much. Actually, the word 'risk' is nowhere in the statement. On growth, Fed seems to expect the weak Q1 GDP growth to be transitory, as it says that private consumption growth has moderated despite solid real income growth and high consumer confidence. Despite weak growth, the Fed confirmed that the labour market continues to strengthen.

No hints of June – we still expect Fed to wait until September

The big question before the meeting was whether the Fed would keep the door open for a June hike or not. While the Fed did not state that *'risks are nearly balanced'*, it did remove *'global economic and financial developments continue to pose risks'*, implying that **we cannot rule out a June hike completely and the Fed keeps its flexibility.** However, the Fed has now lost the possibility of communicating to prepare markets beforehand that June is in play, as was the case in October before the first hike in December. Of course, Fed members can communicate this through speeches but all else being equal, we think by itself this makes a June hike unlikely.

Our main scenario is still that the Fed stays on hold until September and hikes only once this year. For some time, we have argued that we believe the Fed is unlikely to risk tightening too much, too quickly and that it would rather postpone the hike further than tighten prematurely. In this connection, it is important to recognise that most voting FOMC members are skewed towards a dovish stance on monetary policy. **Also, Fed chair Janet Yellen emphasised the downside risks to the economy in her latest speech.** By waiting until September, the Fed is set to get much data that can show whether or not the slowdown in Q1 was transitory and we will be past the UK's EU referendum (remember that the June meeting is held a week before referendum day).

The minutes are likely to show that the members of the committee have had a rich discussion and that the committee is divided.

US monetary policy still supportive factor for global FI market

The patient stance from the Fed – despite the slight change in rhetoric – underlines that US monetary policy is still a supportive factor for the global fixed income market. Hence, it seems that the trigger for a repeat of the global bond sell-off we witnessed a year ago is not going to be US monetary policy for now. That said, the FI market is vulnerable if the money-market starts to move forward the timing of the first rate hike, which is currently not pencilled in before next year.

Financial developments no longer 'pose risks' (at least not explicitly)



Source: Macrobond Financial

Most voting FOMC members are dovish, in our view

2016 year-end Fed funds rate (%)	# of hikes in 2016	2016 FOMC voting members
1.375	4	George
1.375	4	Lacker
1.375	4	Harker
1.375	4	Mester
1.125	3	Lockhart
1.125	3	Williams
1.125	3	Bullard
0.875	2	Powell (B)
0.875	2	S. Fischer (B)
0.875	2	Kaplan
0.875	2	Kashkari
0.875	2	Yellen (B)
0.875	2	Tarullo (B)
0.875	2	Brainard (B)
0.875	2	Dudley
0.875	2	Evans
0.625	1	Rosengren

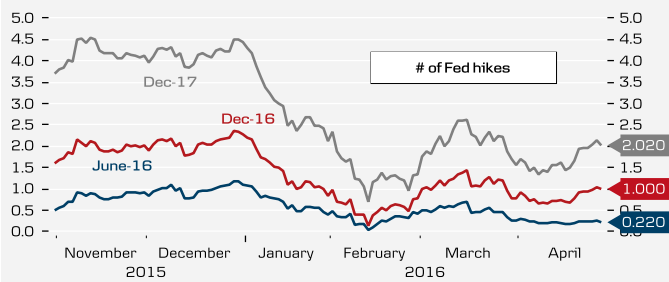
Grey fill indicates voting right

Source: Danske Bank

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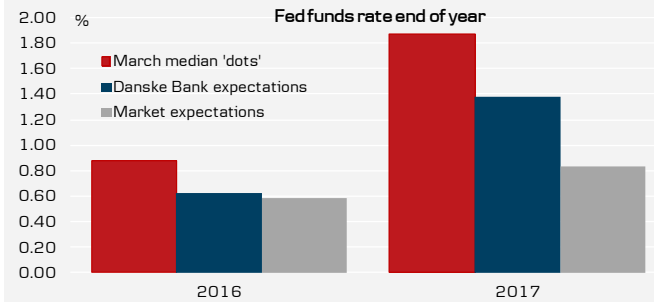
FOMC chart book

Markets expect one hike this year and one next year



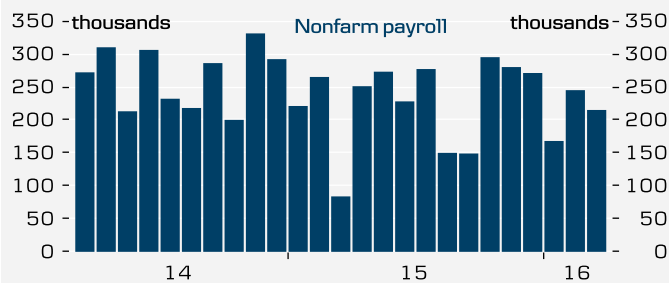
Source: Bloomberg

We expect one this year and three next year – the Fed has signalled two and four, respectively



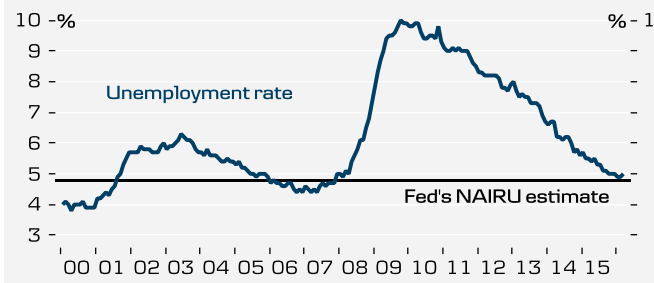
Source: Federal Reserve, Danske Bank Markets

Employment growth continues at a solid pace



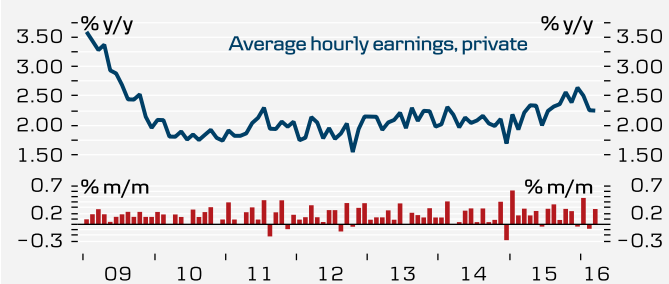
Source: BLS, Danske Bank Markets

Unemployment rate slightly above Fed's NAIRU estimate



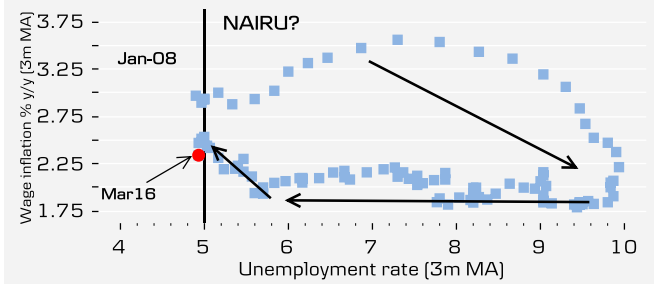
Source: BLS, Danske Bank Markets

Wage inflation is trending up but still subdued



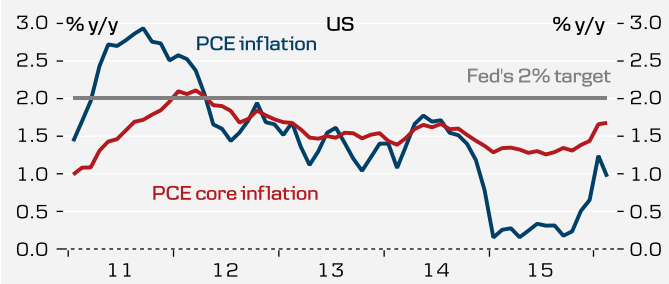
Source: BLS, Danske Bank Markets

Fed sees the world through the Phillips curve



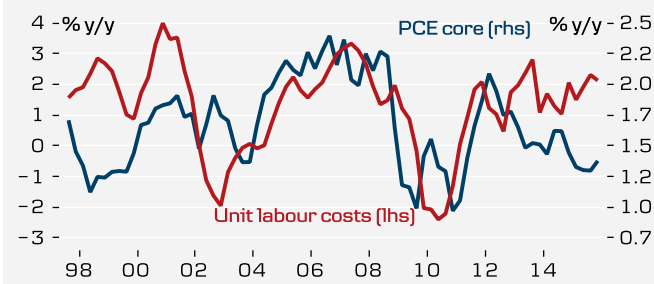
Source: BLS, Danske Bank Markets

PCE core inflation has picked up in recent months



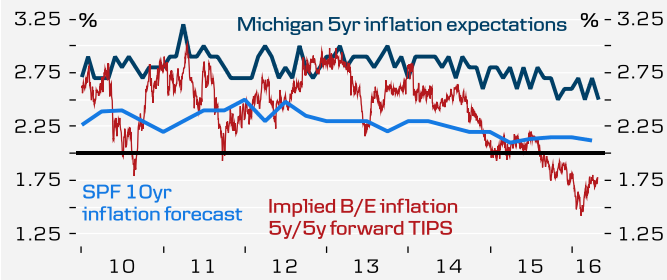
Source: BEA

Unit labour costs indicate higher inflation



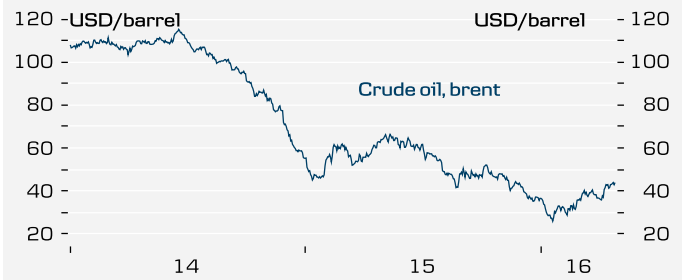
Source: Federal Reserve of Philadelphia, Macrobond Financial, University of Michigan, Danske Bank Markets

Fed concerned about low inflation expectations



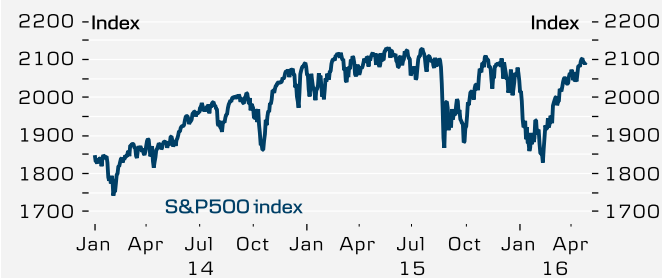
Source: Federal Reserve of Philadelphia, Macrobond Financial, University of Michigan, Danske Bank Markets

Oil price has rebounded



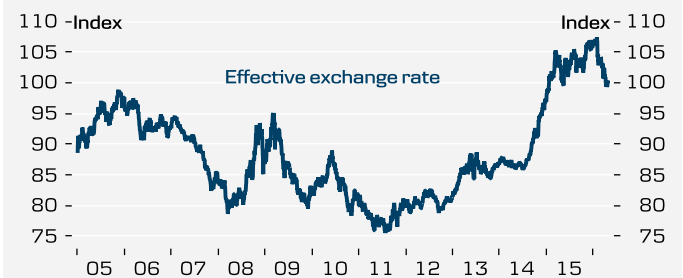
Source: EIA

Rebound in financial markets



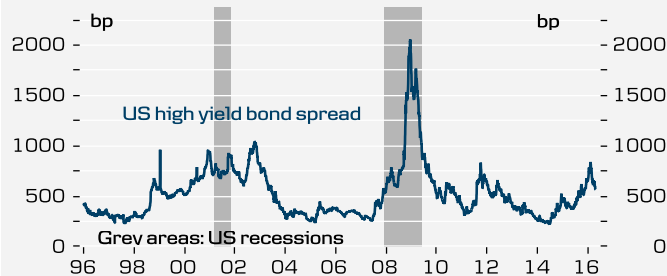
Source: Macrobond Financial

USD has weakened but still relatively strong



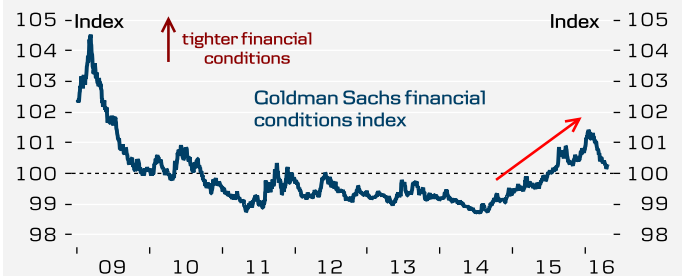
Source: Federal Reserve of Philadelphia, Macrobond Financial, University of Michigan, Danske Bank Markets

Credit spreads have declined but still large



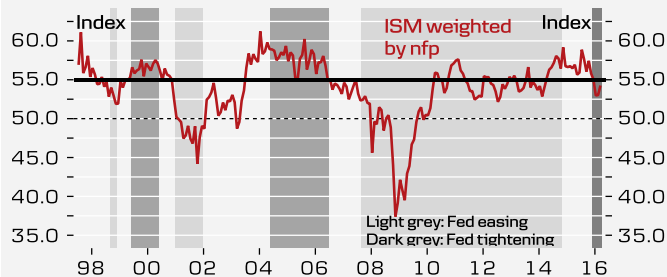
Source: Bloomberg

Financial conditions have eased



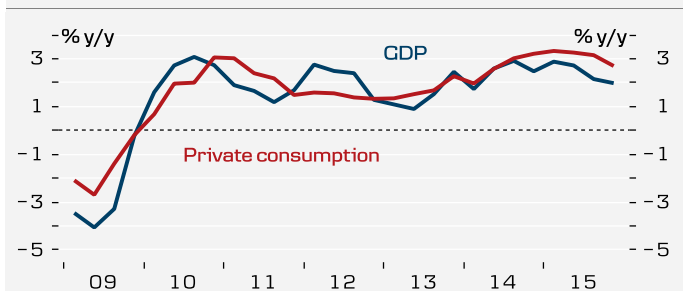
Source: Goldman Sachs, Federal Reserve, Danske Bank Markets

Historically, the Fed has not increased the target range when the weighted ISM index is at the current level



Note: Dark (light) shading indicates periods of tightening (easing)
Source: ISM, Danske Bank Markets

Private consumption main growth driver



Source: BEA

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