

Central Bank Watch

US Fed in dovish pause while rate cut still likely

US Fed concluded its last meeting of 2019 by holding the policy rates steady at 1.5-1.75%, in line with expectations. It also signaled to remain on hold for the time being while monitoring economic developments. Considering the decelerating economy, muted inflation, committee reshuffle and Trump's pressure, rate cuts in 2020 are still on the table. It also hinted at bond purchases, sparking selling in USD.

- **Fed policy is currently on hold with higher thresholds for rates moves in either direction.** FOMC cut rates for three consecutive times in 2019 to guard the economy against the fallout of Trump's prolonged trade tensions and slowing global economy. Fed's latest set of projections showed that FOMC members penciled in no rate changes next year and an increase in 2021. The decision to keep rates unchanged was unanimous, following several dissents in recent meetings. Dot plot indicated that only four predicted higher rates in 2020, down from nine in Sep 2019, leaving the current pause dovish.
- **Fed signaled confidence in economic outlook.** Postmeeting statement removed previous caveat that "uncertainties" about the outlook remained, showing Fed's growing confidence in US economy. With strong household sector and supportive monetary and financial conditions, Fed now expects moderate growth to continue. Fed did not make significant changes in its statement from its previous meeting except for cutting down core PCE and unemployment rate forecasts. Recent data shows some improvement particularly after Nov's increase in payrolls of 266,000. Yet there is another side of story. ISM manufacturing index fell 0.2ppt to 48.1 in Nov, showing that trade disputes and slower global demand had further weighed on larger.
- **Why rate cuts in 2020 are still on the table? 1) Slowing growth:** We believe US economy is in late cycle and will further slow to 1.8% in 2020 from about 2.3% this year. Any weakness in economy may raise the odds of further cuts as the country heads towards presidential election. Remember, Fed could change its view quickly, just like it did this year. **2) Muted inflation:** In our view, inflation will play a crucial role in determining policy rates. Fed has persistently undershot its 2% inflation target. Therefore, Fed needs more upward pressure on inflation. Powell said that Fed's policy rate would remain appropriate until inflation rose persistently, indicating that chances of any rate hike in 2020 will be slim. **3) Membership reshuffle:** It could be easily neglected that the upcoming shuffle on the FOMC makes the outlook for policy changes more challenging to predict. Four regional Fed bank presidents will become voting members after the annual membership reshuffle in Jan 2020. They are likely to form a more dovish group and may favor more easing next year. **4) Trump's pressure:** The "Tariff Man" has urged Powell and Fed to cut rates more aggressively, under zero at best. And Trump's political pressure may drive rate cuts. All these factors make a rate cut in 2020 still likely and we now expect US Fed to stay on hold for the most time next year and to cut rate once by 25bp when it sees appropriate.

Four FOMC members will rotate in beginning next year

2019	George(Kansas)	Rosengren(Boston)	Evans(Chicago)	Bullard(St Louis)
2020	Mester(Cleveland)	Kaplan(Dallas)	Harker(Philadelphia)	Kashkari(Minneapolis)

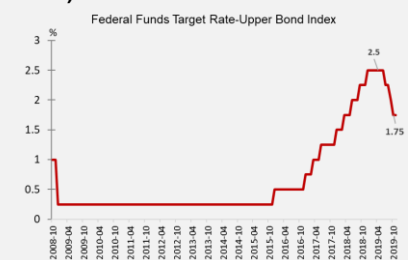
Sources: CMBIS (Dark red refers to hawk, light red refers to hawkish, grey refers to centrist, light blue refers to dovish, dark blue refers to dove)

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US federal funds target rate (upper bond)



Source: Bloomberg, CMBIS

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Figure 1: Changes of economic projections by FOMC members

Variable	Time of FOMC meetings	2019	2020	2021	2022	Longer run
Change in real GDP	2019-12	2.2	2.0	1.9	1.8	1.9
	2019-09	2.2	2.0	1.9	1.8	1.9
	2019-06	2.1	2.0	1.8	-	1.9
	2019-03	2.1	1.9	1.8	-	1.9
Unemployment rate	2019-12	3.6	3.5	3.6	3.7	4.1
	2019-09	3.7	3.7	3.8	3.9	4.2
	2019-06	3.6	3.7	3.8		4.2
	2019-03	3.7	3.8	3.9		4.3
PCE inflation	2019-12	1.5	1.9	2.0	2.0	2.0
	2019-09	1.5	1.9	2.0	2.0	2.0
	2019-06	1.5	1.9	2.0		2.0
	2019-03	1.8	2.0	2.0		2.0
Core PCE inflation	2019-12	1.6	1.9	2.0	2.0	-
	2019-09	1.8	1.9	2.0	2.0	-
	2019-06	1.8	1.9	2.0		-
	2019-03	2.0	2.0	2.0		-
Federal funds rate	2019-12	1.6	1.6	1.9	2.1	2.5
	2019-09	1.9	1.9	2.1	2.4	2.5
	2019-06	2.4	2.1	2.4		2.5
	2019-03	2.4	2.6	2.6		2.8

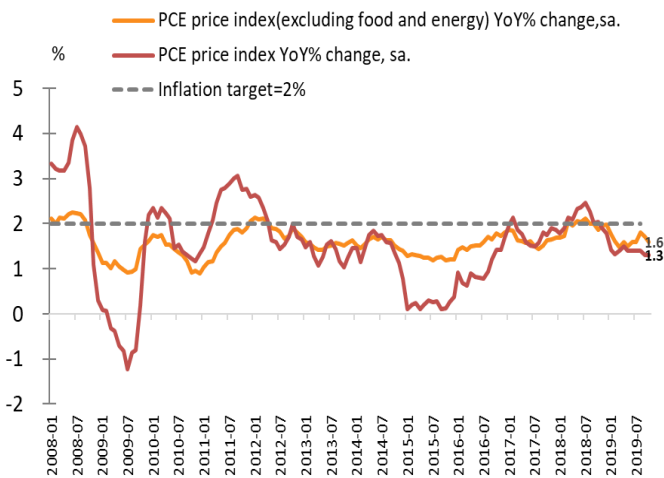
Source: US Fed, CMBIS (Data in red has moved up; data in green has dropped)

Figure 2: FOMC policy statement comparison (Sep vs. Dec 2019)

2019 Sep	2019 Dec
In light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the federal funds rate to 1-1/2 to 1-3/4 percent.	The Committee decided to maintain the target range for the federal funds rate at 1-1/2 to 1-3/4 percent.
This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook remain.	The Committee judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective.
Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; and Randal K. Quarles. Voting against this action were: Esther L. George and Eric S. Rosengren, who preferred at this meeting to maintain the target range at 1-3/4 percent to 2 percent.	Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren.

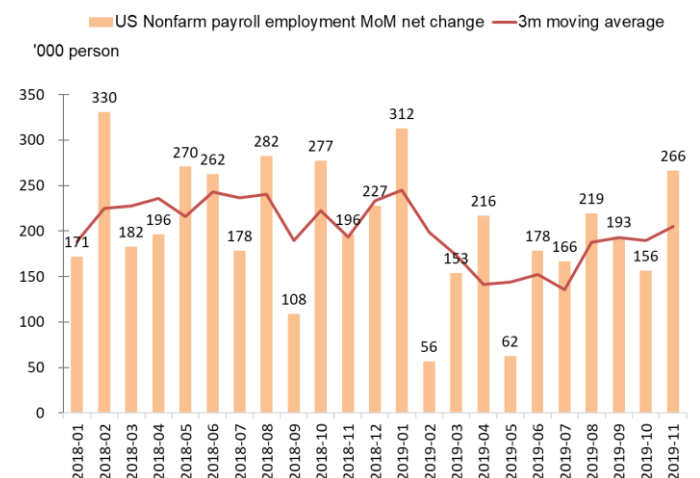
Source: US Fed, CMBIS

Figure 3: Fed's favourable measure of core inflation, core PCE price index, rose only 1.6% YoY in Oct 2019



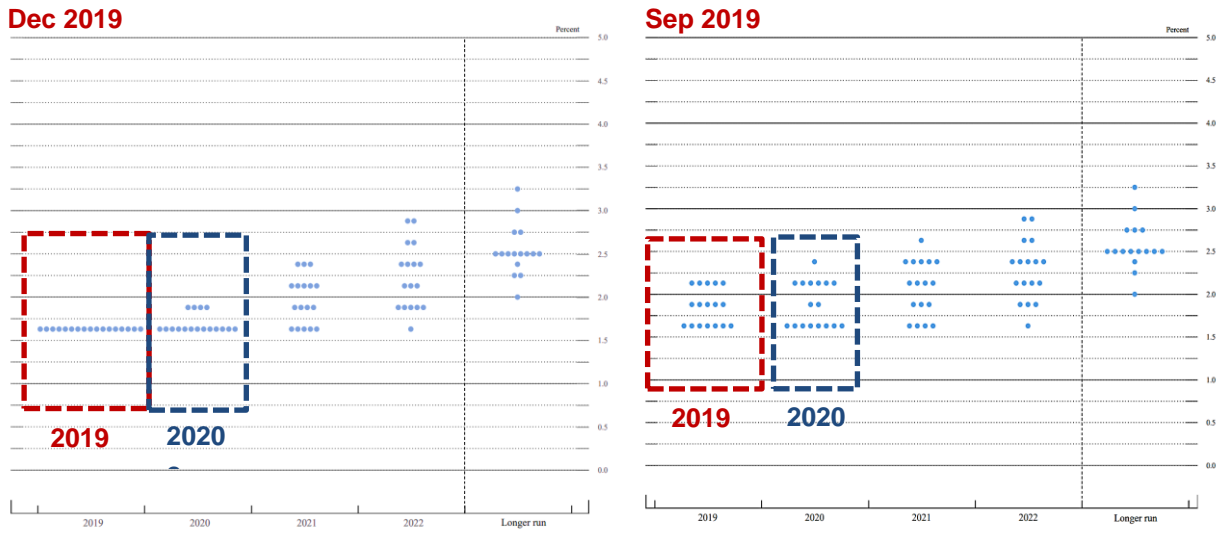
Source: Bloomberg, CMBIS

Figure 4: US nonfarm payroll employment increased by a solid 266,000 in Nov 2019



Source: CEIC, CMBIS

Figure 5: FOMC dot plots comparison (Dec vs. Sep 2019)



Source: US Fed, CMBIS

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