

FOMC preview

Fed to stay on hold this week – likelihood of a December hike has increased due to better economic data

Ongoing 'bird fight'

The FOMC meeting concludes on Wednesday, with the **rate announcement at 19:00 CET** (note that this is an hour earlier than usual as Europe has shifted back to winter time). **We expect it to maintain the target range at 0.25-0.50%, in line with consensus, due to the presidential election next week.** It is one of the small meetings without a press conference or updated 'dots', therefore, **the most interesting part is the FOMC statement.**

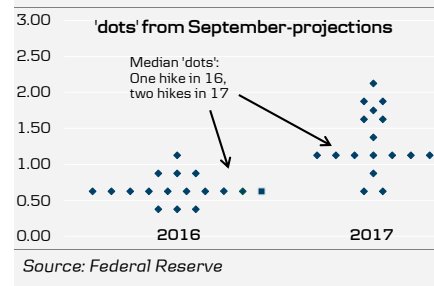
The Fed more and less pre-announced the December 2015 hike at the October meeting but, this time, unlike last year, **the markets have now more or less priced in a Fed hike by year-end as much as possible** given that there are still one and a half months before the December meeting. **Hence, we do not expect any major changes to the FOMC statement at this meeting, as it was already quite hawkish last time,** as it stated that the case for a rate hike had '*strengthened*'. It may say that economic data have supported its view that growth has picked up pace.

We have, for some time, had this non-consensual view that the Fed will not raise the Fed funds target range this year. While this call has come under pressure given the better US economic data, **we still think it is too early to say a December hike is done deal although admittedly the probability has increased significantly.** We still have some important data releases left (not least two jobs report) before the Fed has to make up its mind so we intend to continue monitoring incoming data, as there are still valid arguments for not hiking this year at all. The FOMC members were very divided at the latest FOMC meeting back in September as three voted for an immediate hike while three members indicated that Fed should not hike at all.

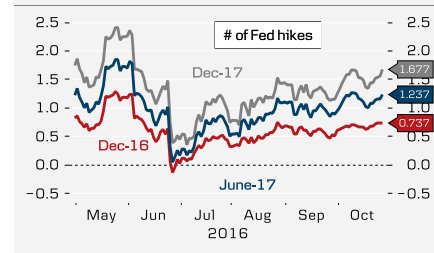
The hawks are ready to raise rates. Generally, they think that inflation and employment are at, or close to, their targets levels and thus monetary policy needs to be tightened to avoid an overheat. The hawks also think that Fed may risk creating asset bubbles by keeping rates low. The doves focus on the persisting labour market slack (unemployment and underemployment rates have moved sideways suggesting there is more slack left than previously thought), subdued wage growth and inflation running below target meaning that the economy has "room to run".

If Fed is about to hike rates in December, the next question is how many hikes to expect next year? The 'median' dot last time indicated two hikes. However we think it is important to remember that Fed shifts towards a more dovish direction as Mester, George and Rosengren (who all voted for a hike at the September meeting) lose their voting rights. Also we think it is interesting that Fed Chair Yellen in her latest speech talked about letting the economy run hot to undo some of the damage to the economy caused by the financial crisis. So it could be that the Fed wants to let inflation overshoot the inflation target. The Fed also struggles with less credibility, as it has failed to hit the 2% target since 2008 (except for five months). If so, 'once a year' could be a hiking pace we should get used to – especially given that we may see further downward corrections of the expected Fed funds rate in the longer-run.

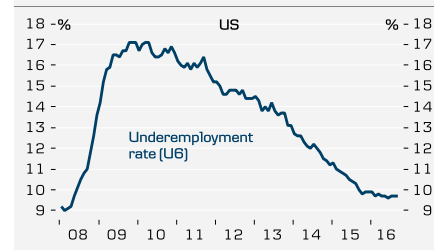
FOMC was very divided in September



Markets have priced in a high probability of a December hike



Doves argue there is more slack left in the labour market as the underemployment rate has stopped declining

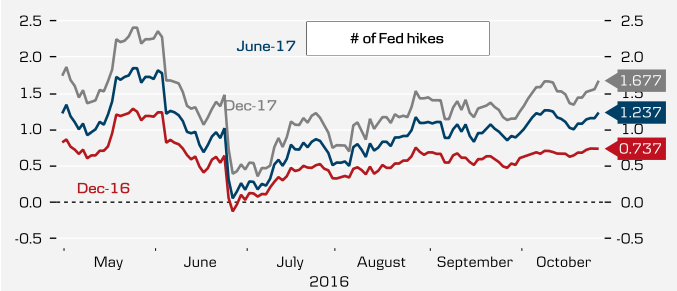


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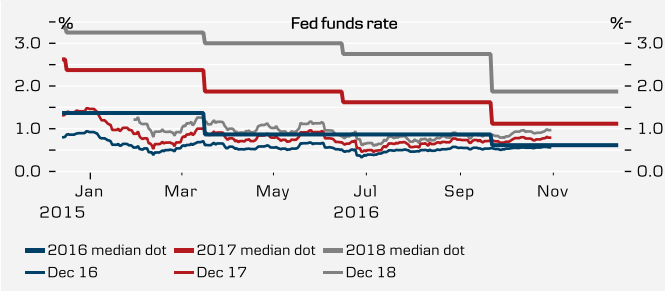
FOMC chart book

Markets have priced in a high probability of a December hike



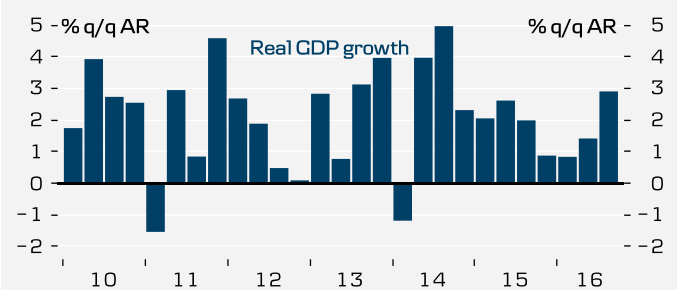
Source: Bloomberg

Markets still do not believe in 'dots'



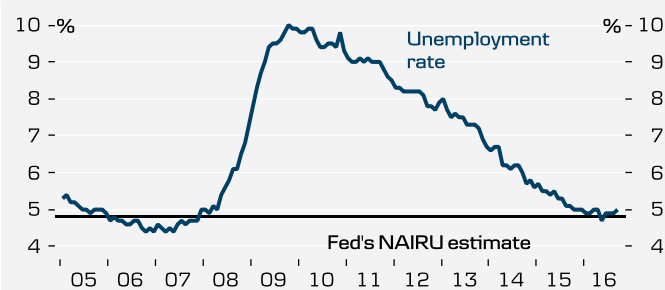
Source: Federal Reserve, Bloomberg

GDP growth picked up in Q3 after three weak quarters



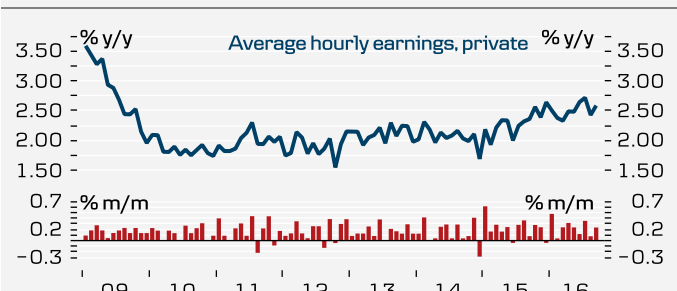
Source: BEA, Danske Bank Markets

Unemployment rate has moved sideways for some time



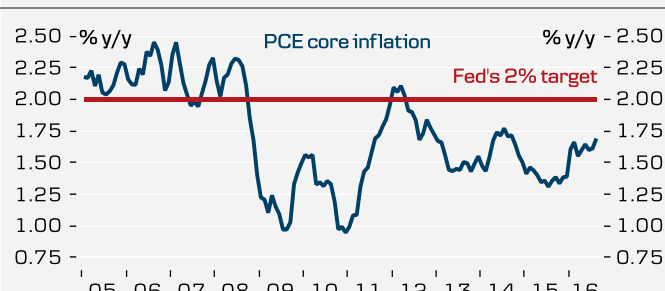
Source: BLS, Danske Bank Markets

Wage growth has picked up but is still subdued



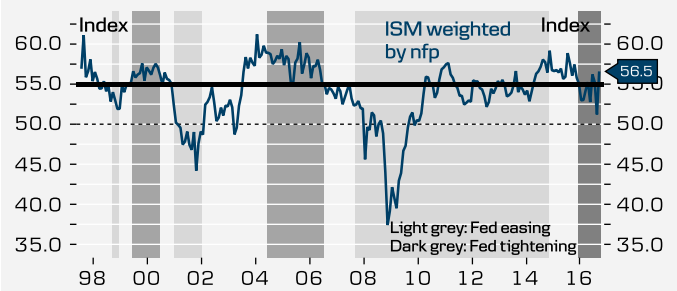
Source: BLS, Danske Bank Markets

PCE core inflation has moved sideways this year - it has only been at or above target for five months since 2008



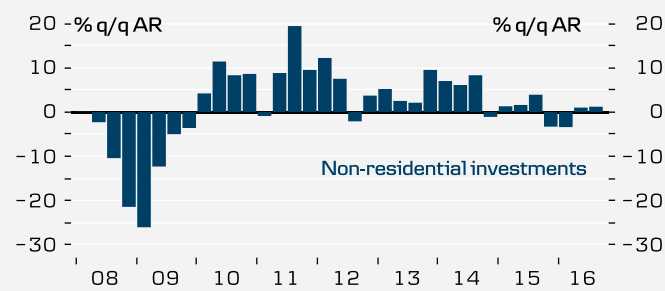
Source: BEA, Federal Reserve

Positive news that ISM has rebounded sharply



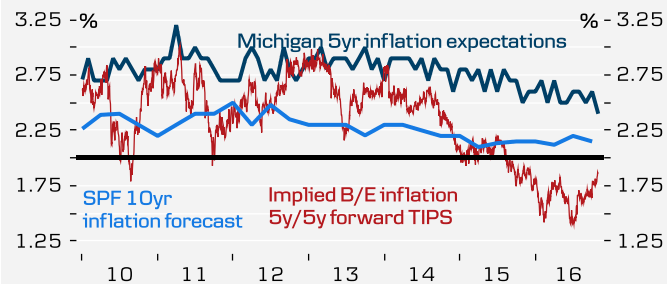
Source: ISM, BLS, Danske Bank Markets

Weak business investments



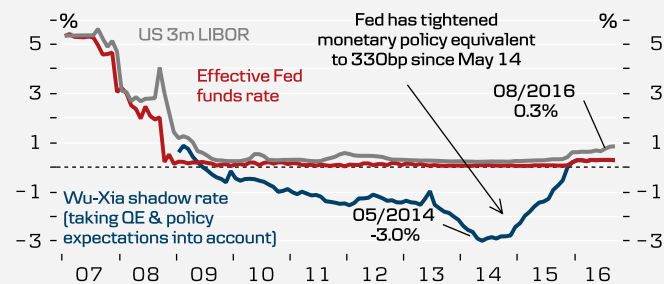
Source: BEA

Market inflation expectations have recovered but still low from an historical perspective



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

The Fed has already tightened monetary policy equivalent to 330bp due to QE tapering and hiking expectations



Source: Federal Reserve, Federal Reserve Bank of Atlanta, Macrobond Financial

S&P500 has moved sideways for some time



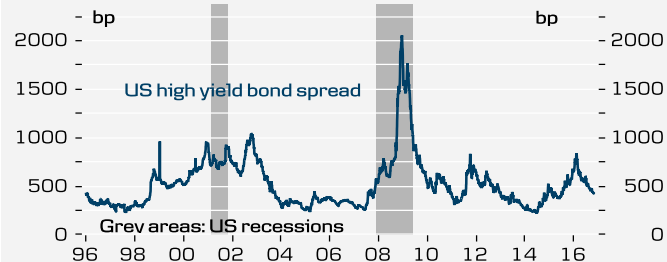
Source: Macrobond Financial

USD has strengthened recently



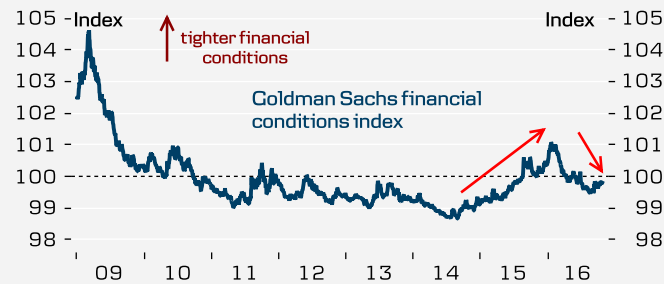
Source: Federal Reserve of Philadelphia, Macrobond Financial, University of Michigan, Danske Bank Markets

Credit spreads have declined but are still large



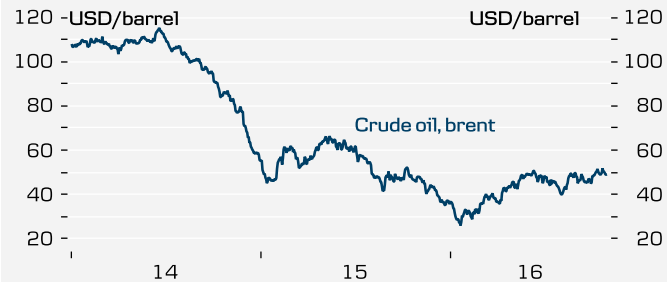
Source: Bloomberg

Financial conditions have eased



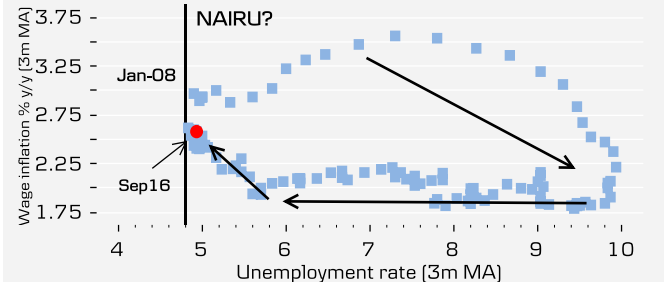
Source: Goldman Sachs, Federal Reserve, Danske Bank Markets

Oil prices have stabilised around 50 US dollars per barrel



Source: EIA

Fed sees the world through the Phillips curve



Source: BLS, Danske Bank Markets

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Expected updates

None.

Date of first publication

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