Investment Event

27 September 2018
For Client Use

The Fed continues normalising policy

At the September meeting, the Federal Reserve (Fed) raised the fed funds target range by 25bp to 2.00-2.25%

The Fed has raised a total of 200bp since the start of the hiking cycle in December 2015

Given its economic and inflation outlook, the Fed is expected to continue normalising monetary policy

Our views

We do not change our asset class view as a result of this Fed meeting. An inflation shock in the US is still the biggest risk to a multi-asset portfolio

The Federal Reserve raised rates by 25bp to 2.00-2.25%

As widely expected, the Fed unanimously decided to raise the target range for the fed funds rate by 25bp to 2.00 2.25% at its September meeting. The monthly "cap" system for balance sheet shrinkage was left unchanged. This was the first voting meeting for Vice Chairman of the Board of Governors Richard Clarida

Little change to projections and forward guidance

The latest Summary of Economic Projections maintained an upbeat assessment of economic activity. GDP growth forecasts for 2018 and 2019 were upgraded to 3.1% (previously 2.8%) and 2.5% (previously 2.4%), respectively. Core PCE inflation is still expected to stay broadly close to 2.0% in both 2018 and 2019. Meanwhile, the unemployment rate forecast picked up modestly to 3.7% (previously 3.6%) this year and is anticipated to remain at 3.5% for the following two years.

The median projection of interest rates (or "dot plot") still signals a total of four rate hikes in 2018, but the distribution has moved slightly higher. As before, three rate hikes are pencilled in for 2019. The median terminal rate was re-assessed to 3.0% (previously 2.875%).

Elsewhere, the accompanying statement dropped the word "accommodative" to describe the monetary policy stance. However, Fed Chair Powell emphasised that this purely reflects the fact that interest rates are now closer to policymakers' long run terminal rate. At the press conference, he did not convey any major surprises, acknowledging that the US economy remains strong while noting that prolonged trade tensions could lead to downside risks.

HSBC

Rates inching towards "neutral", with some upside risks

Given the backdrop of good growth, continued tightening of the labour market, gradually rising wage growth and close-to-target inflation, we expect the Fed to continue normalising policy at the current pace.

Interestingly, Chicago Fed President Charles Evans, who dissented against the December 2017 rate hike, recently said that "given the outlook today, I believe this will entail moving policy first toward a neutral setting and then likely a bit beyond neutral". Evans will be voter in 2019:

Table 1: the FOMC line-up in 2019

Board of Governors	Chair	**Jerome Powell**	Centrist
	Vice Chair of BoG	**Richard Clarida**	Centrist
	Vice Chair for Supervision	**Randal Quarles**	Centrist
	Governor	**Lael Brainard**	Dove-ish
	Governor	**Michelle Bowman***	Centrist
Regional Presidents	New York	**John Williams**	Hawk-ish
	Chicago	**Charles Evans**	Hawk-ish
	Boston	**Eric Rosengren**	Hawk
	St. Louis	**James Bullard**	Dove
	Kansas	**Esther George**	Hawk

(*) Still waiting Senate confirmation. There are still two more unfilled seats in the Board of Governors.

Source: US Federal Reserve, HSBC Global Asset Management, September 2018

Market considerations

Market pricing of future rate hikes has moved up in recent weeks, leaving a higher hurdle for the Fed to surprise to the upside. We do not alter our asset class view as a result of this monetary policy decision.

To us, with wage growth inching higher, an inflation shock in the US is the biggest risk to a multi-asset portfolio. Such a scenario will weigh on US fixed income assets, as well as US equities, as corporate margins would be squeezed. If the Fed responds aggressively, this could also result in a stronger US dollar, which could be a potential headwind to EM currencies. We will continue to monitor this risk closely.

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