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FOCUS NOTES

December FOMC meeting: Broadly unchanged hiking signals

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- **The FOMC fulfils market expectations and delivers the third rate hike this year.** In line with market expectations, the FOMC delivered at 25bps rate hike at this week's two-day monetary policy meeting, the 3rd hike this year, taking the fed funds rate to 1.25-1.50%. Two FOMC members, Charles Evans (Chicago Fed President) and Neel Kashkari (Minneapolis Fed President) dissented, voting in favor of unchanged interest rates due to the lack of progress on inflation. These two members are among the four Reserve Bank Presidents in the 12-seat FOMC who will lose their voting rights next year (Reserve Bank Presidents serve one-year terms on a rotating basis).

- **December FOMC statement.** The accompanying statement was little changed compared to that issued at the last meeting. The FOMC reiterated that economic activity has been rising at a solid rate, household spending has been expanding at a moderate rate and growth in business fixed investment has picked up in recent quarters. With respect to inflation, the Committee repeated that market-based measures of inflation compensation remain low while, survey-based measures of longer-term inflation expectations are little changed, on balance. The only major change was related to the labor market. The FOMC upgraded its assessment saying that "job gains have been solid".

- **Updated economic projections.** GDP growth projections were revised higher throughout the four-year forecast period; to 2.5% for 2017 from 2.4%, to 2.5% for 2018 from 2.1%, to 2.1% for 2019 from 2.0% and to 2.0% for 2020 from 1.8%, all above the FOMC's take on "longer run" or potential growth. In fact, potential growth was left unchanged at 1.8%, suggesting that the FOMC does not share the view that the tax reform could improve the rate of productive potential for the economy. Speaking at the post-meeting press conference, Chair Janet Yellen revealed that "most" FOMC participants have incorporated into their projections the expected impact from the awaited tax reform, suggesting little scope for further upward revisions in GDP growth forecasts if the final tax bill is approved by Congress, expected by the end of this year (a final tax reform bill is expected to be unveiled on Friday, December 15 and votes in both Chambers to be held next week). With respect to the unemployment rate, the median expectation was lowered by 0.2pp throughout the forecast period expected now to stand at 3.9% in both 2018 and 2019 before moving 0.1pp higher to 4.0% in 2020 and ultimately rising to 4.6% in the long run. Inflation forecasts were little changed suggesting that any impact from the tax reform is likely to be moderate. In the accompanying statement, the FOMC reiterated that inflation will be "closely" monitored while Chair Janet Yellen repeated that low inflation is probably due to transitory factors. Core PCE inflation, the FOMC's preferred gauge of inflation, is expected to accelerate from 1.5% in 2017 to 1.9% in 2018 and to 2.0% in 2019, unchanged compared to September projections.

- **Projected appropriate policy path.** In spite of the upward revision in GDP growth forecasts, the updated FOMC "dot plot" suggested no shift in monetary policy deliberations for 2018 and 2019 compared to what the committee envisaged in September. The median "dot" expectations for the fed funds rate continue to imply three hikes in 2018 and two in 2019. Where the FOMC's policy stance changed a little is for 2020 where the median expectation increased to 3.1% against 2.9% in September, pointing to one additional hike for the year. The long-run median dot remained unchanged at 2.8%.

- **Knee-jerk market reaction.** Disappointing those who expected that the FOMC could move to a more aggressive monetary policy stance ahead of the expected legislation of the tax reform bill, US Treasuries firmed before giving back some of post-FOMC gains in European trade on Thursday. After marking a multi-session low close to 2.34% shortly after the conclusion of the FOMC meeting, the 10-yr yield moved higher hovering around 2.37% in late European trade, albeit still below a peak close to 2.43% hit early on Wednesday ahead of the FOMC policy announcement. In FX markets, the USD moved slightly lower against G10 currencies with the DXY index hitting a multi-session low of 93.328 early on Thursday before rebounding modestly to levels around 93.495 at the time of writing, albeit still 0.6% weaker from Tuesday's settlement. Against this background, the EUR/USD rebounded marking a one-week high of 1.1843 after falling to a three-week low of 1.1716 earlier this week. With the FOMC meeting out of the way, focus now turns to today's ECB monetary policy meeting. The Central Bank is widely expected to stay put on interest rates while President Mario Draghi is likely to adopt a less dovish tone at the post-meeting press conference following a recent string of upbeat euro area economic data. Should this be the case, the prospect of the EUR/USD extending post-FOMC gains cannot be ruled-out. However, with an ECB rate hike remaining a distance prospect amid persistently subdued inflation pressures in the euro area, any further gains are likely to prove limited with the pair likely to continue consolidating within 1.1700-1.1900 recent range by year-end.

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