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November FOMC: Still on track for a December rate hike

Olga Kosma
Research Economist
okosma@eurobank.gr

Paraskevi Petropoulou
Senior Economist
ppetropolou@eurobank.gr

- As broadly expected, the Federal Reserve maintained its target range for the fed funds rate at 1.00-1.25% in a unanimous decision. The new Vice Chair for supervision, Randal Quarles, attended his first FOMC policy meeting, and cast his vote with the majority for no change in policy. According to the FOMC post-meeting statement, the balance sheet normalization program that was initiated at the September meeting and began in October "is proceeding". The meeting did not provide any new clues regarding the short-term policy outlook. In line with other mid-quarter FOMC policy meetings, it was not accompanied by a press conference by the Chair of the Committee and an update of economic and fed funds rate projections. Besides, a number of policymakers have already communicated that there is a high chance for a 25bp rate hike at the December FOMC meeting on the conviction that the ongoing improvement in labor market conditions will eventually lead to higher inflation, and so there was no need for the Committee to influence market expectations by changing the wording of December's policy statement.

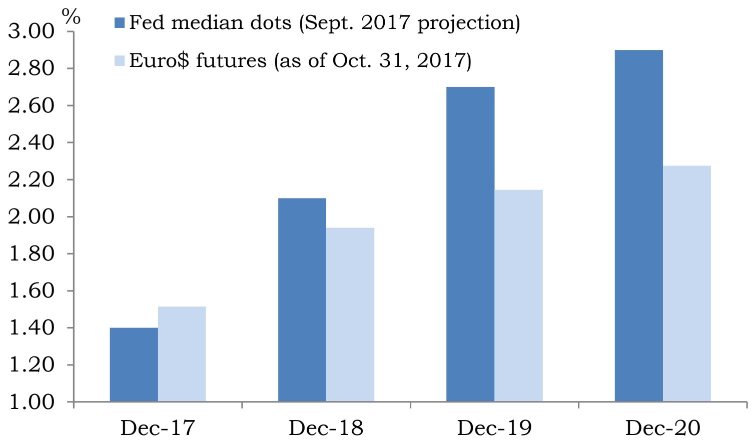
- In the accompanying FOMC statement, the Committee upgraded the assessment of the US economy, noting that activity was rising "at a solid rate despite hurricane-related disruptions". It seems that the Fed observed enough evidence in the post-hurricane data flow pertaining to the Q3 GDP advance estimate to highlight that household spending has been "expanding at a moderate pace" and business spending "has picked up in recent quarters". In line with the September statement, the Committee repeated that the hurricanes would boost gasoline prices temporarily, leading to stronger headline inflation in September. Nevertheless, core inflation was said to have "remained soft", without signaling a change in the Committee's overall outlook for inflation. In the Fed's view, headline and core inflation over a 12-month horizon are expected to remain somewhat below 2.0% in the short-term but to stabilize around the 2.0% target in the medium term. Similar to the economy and inflation, the Committee said that although the hurricanes resulted in a decline in payroll employment in September, the unemployment rate declined further.

- Altogether, the Fed acknowledged strong labor markets, with inflation expected to rise towards the 2.0% target over the medium-term and risks for the economic outlook appearing roughly balanced. Therefore, we continue to expect another 25bp increase in the target range in December. The upward assessment of economic activity further strengthened the prospect for a hike next month, with future implied probability currently standing at 92%, up from ca. 83% before the conclusion of the November FOMC meeting.

- Market reaction to the FOMC policy announcement was muted, as the parts of the accompanying statement relevant to policy guidance were left unchanged. Focus has now shifted to the long-awaited release of the Republic House draft legislation on tax reform later today (around 14:00CET), original planned to be unveiled yesterday. Moreover, market participants are eagerly awaiting the Fed Chair nominee by the US President (expected at around 20:00CET) with the latest press reports conveying that Fed Governor Jerome Powell will probably be Donald Trump's choice. On the prevailing view that Mr. Powell -considered as most similar to incumbent Chair Janet Yellen and, thus, not expected to deviate much from current Fed monetary policy will likely be nominated- the USD was slightly weaker in European trade. The DXY index was 0.2% lower on the day hovering around 94.640/45 in European trade at the time of writing, remaining below last week's three-month peak of 95.150. Against this background, the EUR/USD was standing close to 1.1650/55, continuing to consolidate within the 1.1570/1.1670 range that prevails in nearly a week, exhibiting resilience to the escalating political crisis in Catalonia and increased US tax reform optimism. Turning to USTs, short-dated paper continued to underperform the rest of the curve on the prevailing view for a 25bps FOMC rate hike in December.

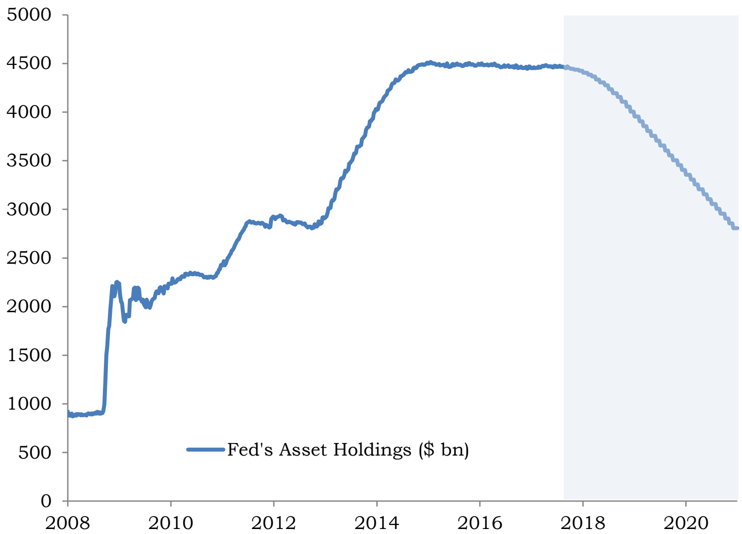
  The scenario of Jerome Powell succeeding Janet Yellen seems to be already priced-in. Thus, such an announcement is likely to be taken in stride by market participants. However, should the US President nominate instead the other leading candidate academic macroeconomist John Taylor, who has been persistently critical of the Fed's easy-monetary policy stimulus since the financial crisis, we could see a hawkish market reaction. Technically, key support for the EUR/USD stands at 1.1600/1.1550, while a sustained break above the 2.40% threshold for the 10-yr Treasury yield could open the way towards this year's 2.60% high.

Figure 1
Fed dots still above market expectations on a medium/long term horizon



Source: Bloomberg, Eurobank Research

Figure 2
Shrinkage of Fed balance sheet expected over the next 3 years towards ca. $2.8trn



Source: Federal Reserve, Eurobank Research

Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@eurobank.gr, + 30 210 37 18 903

Dr. Tassos Anastasatos: Deputy Chief Economist
tanastasatos@eurobank.gr, + 30 210 33 71 178

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 37 18 793

Ioannis Gkionis: *Research Economist*
igkionis@eurobank.gr + 30 210 33 71 225

Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226

Olga Kosma: *Research Economist*
okosma@eurobank.gr + 30 210 33 71 227

Marianna Papoutsaki
mpapoutsaki@eurobank.gr + 30 210 33 71 224

Paraskevi Petropoulou: *G10 Markets Analyst*
ppetropoulou@eurobank.gr, + 30 210 37 18 991

Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922

Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 33 7 1 228

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

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