GLOBAL ECONOMY AND FINANCIAL MARKETS SHORT COMMENTARY

AMG 安柏 FINANCIAL GROUP

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Market volatility is back as Fed uncertainty hit sentiment

On 17 June, the fourth FOMC meeting in 2021 signaling that broad changes in policy may happen sooner than expected as Fed officials projected an accelerated rate hike timetable on higher economic growth expectation and inflation projection this year, even though the policy action maintained unchanged after the meeting.

- Maintain the federal funds rate in a target range of 0 to 1/4 percent.
- Increase the System Open Market Account holdings of Treasury securities by $80 billion per month and of agency mortgage-backed securities (MBS) by $40 billion per month.

The Fed said it will keep the federal funds rate near zero despite signs the economic recovery is well underway.

1. The Fed has increased its forecasts for economic growth and inflation projection in 2021, comparing to the forecasts made in previous meeting in March. The forecast for economic growth in 2021 increased from 6.5% to 7%; the inflation projection for 2021 accelerated from 2.4% to 3.4%. The Fed held the similar position to the forecast for 2022 and 2023.

2. Rate hike could came earlier than expected as reflected in the Fed' dot-plot, Federal Reserve officials signaled they expect the federal funds rate will increase before the end of 2023, sooner than they anticipated in March, as the economy recovers rapidly from the impact of the pandemic and inflation heats up. The forecast is presented by dot-plot with anonymous entries from central bank officials. The number of officials increased to 7 suggested a rate hike before the end of 2022, vs. 4 in March's meeting. Besides, it is 13 officials (out of total 18) suggested rate hike in 2023, which is the 1st time more than half officials suggested rate hike in 2023 since the pandemic.

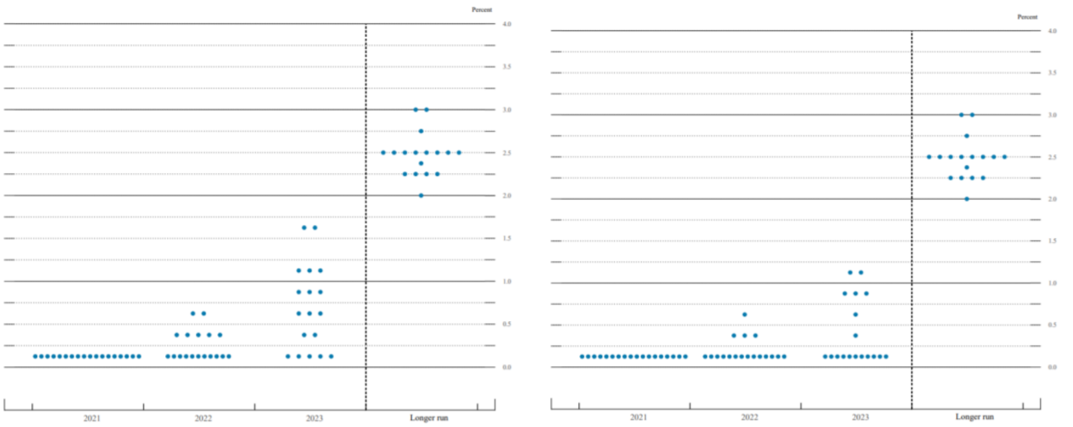
Fed's latest projection on the GDP growth, unemployment rate and inflation

Percent

Variable	Median[1]			
	2021	2022	2023	Longer run
Change in real GDP	7.0	3.3	2.4	1.8
March projection	6.5	3.3	2.2	1.8
Unemployment rate	4.5	3.8	3.5	4.0
March projection	4.5	3.9	3.5	4.0
PCE inflation	3.4	2.1	2.2	2.0
March projection	2.4	2.0	2.1	2.0
Core PCE inflation[4]	3.0	2.1	2.1	
March projection	2.2	2.0	2.1	
Memo: Projected appropriate policy path				
Federal funds rate	0.1	0.1	0.6	2.5
March projection	0.1	0.1	0.1	2.5

Source: U.S. Federal Reserve

The latest dot-plot by Fed officials on interest rates (left)
March's dot-plot by Fed officials on interest rates (right)



Source: U.S. Federal Reserve

The latest dot-plot pointed to at least two rate hikes in 2023 which spooked markets, but Powell said those projections need to be taken with a 'big grin of salt'.

1. The Fed has substantially increased its inflation projection in 2021, reflecting the recent high inflation pressure may not be a matter of two or three months alone, and it is expected to remain high in a longer period of time. The market is worried that if high inflation stands longer, the faster the Fed will tighten its monetary policy.

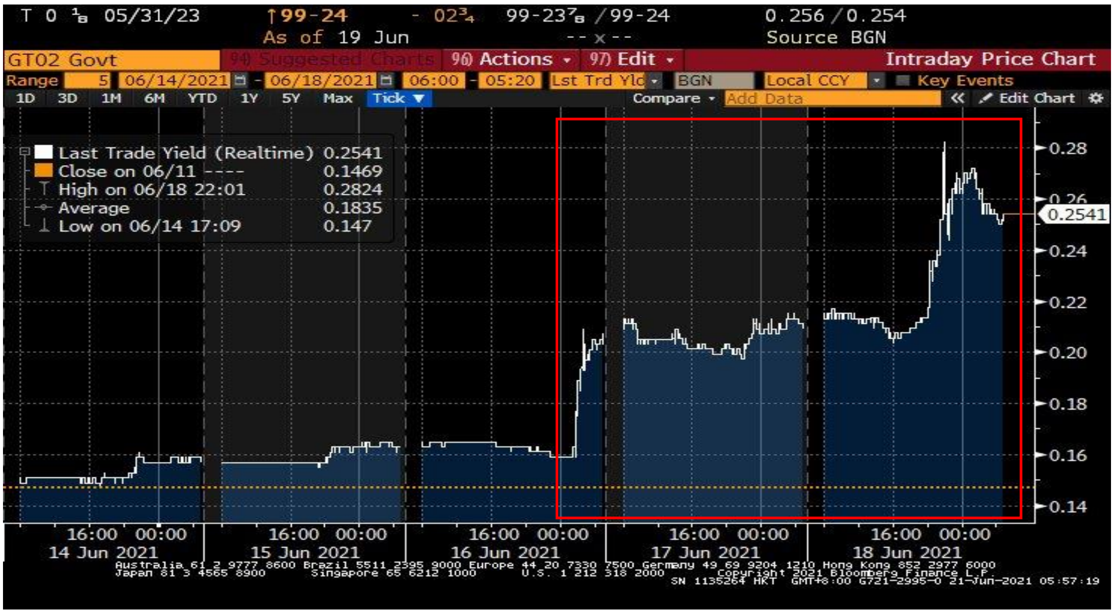
2. 7 officials now expect the federal funds rate will be lift in 2022, up from 4 officials in March, though it is still less than half. Therefore, it is still not very likely the interest rate will bump up in 2022. However, there are 6 committees changed their mind for rate hike in 2023 than in March. The first time that the number of officials more than half. The split 13 to 5 against a 2023 hike and it moves the median forecast

to 0.6%.

Stocks and short-term Treasury bond yield slid amid these findings, it is most likely affected by the rate hike could come earlier.

- 2-year Treasury bond yield: it jumped from 0.16% before the meeting to 0.25% on 18 June.
- The stock market did not slip significantly after the release of the meeting statement and the upgraded economic and inflation projection. However, it sparked a selloff in stock market on the next two trading days with fall down of more than 2%.

US 2-year Treasury bond yield



Source: Bloomberg

Dow Jones Industrial Average Index

Source: Bloomberg

Fed Chair Powell warned against reading too much into dot-plot, saying the projections need to be taken with a ‘big grain of salt’. The market curtailed its losses. Stocks rebounded from their session lows after Powell said that rate hikes in 2023 still remain uncertainty. Powell’s comments on interest rate is expected to sound dovish and assure markets the Fed’s policy will remain easy.

- Powell warned of over-reading the dot plot, saying “it’s not a great forecaster of future interest rate and to anticipate the direction of the Fed's policy, as there will be many variables at any time in between.
- Regarding inflationary pressure, the Fed claimed that the recent spike in inflation is temporary. Powell said he continued to believe that recent higher-than-expected price increases were driven by the peculiarities of trying to reopen the $20 trillion-a-year economy. Even though Powell acknowledged high inflation may persist for a while, he reassured that he is confident the high inflation will eventually come down and the recovery has still a “long way to go” suggesting he is not eager to pull support sooner.
- Powell declined to offer guidance on the timing for any future policy shift, emphasizing that more economic data needs to be in hand. He reiterated that Fed wanted to see "substantial further progress" in employment before making any policy shift, and it is still "far" from their goal of restoring maximum employment.

Source: CNBC, Reuters, Bloomberg News

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