Weekly Market Summary

September 28th, 2018

Never Mess Up With Reliable Fed Dot Plots & Trustworthy Presidential Buddies!!
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Back in early 2011, as the US Federal Reserve was winding down its second round of Quantitative Easing ("QE") and plotting an exit strategy, the then-Fed Vice Chair Janet Yellen, together with a sub-committee, were working on a communication strategy to convey to the public more information about the Fed's expectations for the future path of short term US interest rates. After months of hard work and creative thinking (☺), the sub-committee came up with a magical chart: *'The Fed's Dot Plot'!*

To date, the Federal Open Market Committee ("FOMC") main duty is to meet regularly (eight normal occurrences, 6-7 weeks intervals) and discuss the latest domestic and global economic trends as well as evolving financial conditions. Accordingly, they would decide on a new target for the federal funds rate (the rate banks charge each other for overnight loans to meet their daily cash requirements and reserve balances), whilst ensuring afterwards that it is enforced by Open Market operations (temporary reverse repos and matched sales transactions carried daily by the trading desk at the Federal Reserve bank of New York) and adjustments in the interest rate on reserves. The target rate is always what is covered by the media when referring to the Federal Reserve "*changing interest rates*." The actual or "effective" federal funds rate generally lies within a range of that target rate, as the Federal Reserve cannot set an exact value through its daily market operations. The rate change (or lack of it) announcement is simultaneously followed with a short Fed statement outlining the rationale for the central bank latest decision.

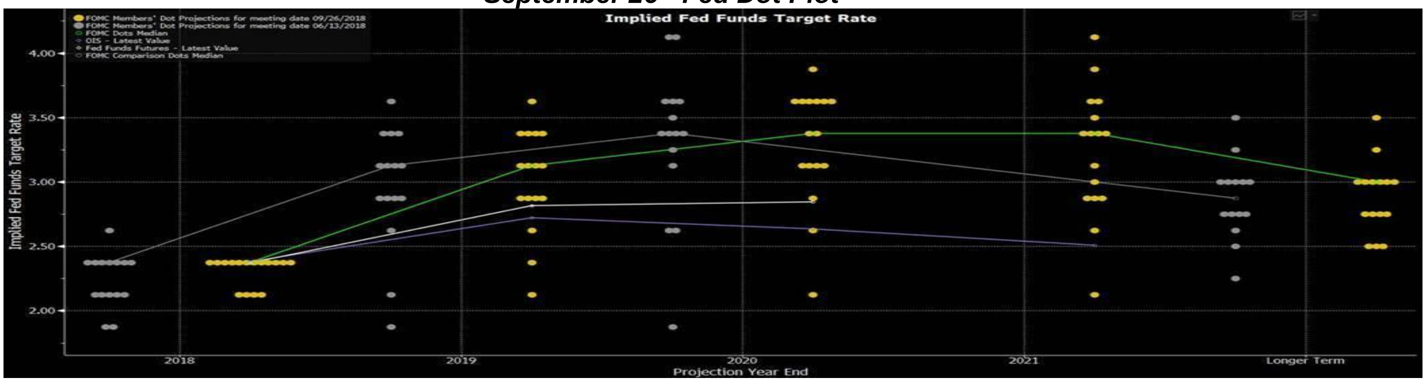
Nowadays, as central bankers signal rate moves well-ahead of planned meetings to ensure market volatility stays tame (I would personally favour a Fed that removes the punch bowl without prior notice, a la Fed Chairman William McChesney's approach back in the mid-twentieth century!), the Fed Dot Plot has become probably the most closely scrutinized scatter chart and de facto official monetary policy forecast for world financial markets. It is also an important source of clues to those dissenters within the Fed's policy-making committee! The chart effectively shows estimates of what the federal funds rate should be, with members of the rate-setting Federal Open Market Committee each assigning a dot (though dots carry no name of specific Fed officials) for what they view as the midpoint of the rate's appropriate range at the end of each of the next three years and over the longer run. As many as 19 monetary policy makers - the seven governors on the Fed Board in Washington and the presidents of the 12 regional banks - can contribute a dot (nowadays investors only see 16 dots, as there are three vacancies on the board), though traders' focus is usually on the median dot.

When the Dot Plot shifts, it can send a powerful message to investors on whether the U.S. central bank expects to speed up or slow down its planned tightening of monetary policy, **even though various Fed officials have in the past suggested that those projections do not reflect a commitment by the FOMC to act and that they are not an official consensus forecast.** Back when the dots were officially introduced in January 2012, Fed Chairman Ben Bernanke was clear that they weren't "*unconditional pledges*". "*There is no mechanical relationship between these projections and the outcomes of the FOMC decisions,*" he said. At the March 21st FOMC meeting, current Fed Chairman Jerome Powell played down the importance of the longer-range dots too; Asked by reporters about the median rate forecast for 2020, he said policy makers "*don't have the ability to see that far into the future*". Further complicating things, of the 12 regional Fed presidents, only five are voting members of the FOMC in any given year, which in turn raises questions over how well the dots accurately reflect longer-term FOMC intentions (as FOMC membership changes and the people behind the dots gets replaced!).

One thing is for sure though: The Dot Plot creates a benchmark that can be used to highlight differences between the Fed's official view and that of the financial markets.

In fact, the central bank has been consistently more upbeat about its ability to lift inflation and therefore interest rates - than investors - though this gap (the difference between the Fed rate projections and market/traders' views on interest rate futures) narrowed during 2017 and again this year, as economic growth picked up and the Fed delivered on its rate hike promises.

September 26th Fed Dot Plot



Major summary of last Wednesday, September 26th FOMC meeting:

- *The Federal Open Market Committee – as widely expected - increases the federal funds rate 25 basis points to a range 2% to 2.25% (8th rate hike since late 2015). Short-term USD LIBORs hardly moved (1-2 bps higher).*
- *The FOMC also projects one more hike before the end of the year and three in 2019 (Fed Dot Plot). Forecasts show 12 of 16 officials favour four hikes in 2018*
- *Wednesday's statement dropped language saying that "the stance of monetary policy remains accommodative (Fed Chairman Jerome Powell downplayed the significance of such language change during his ensuing press conference).*
- *Fed officials collectively estimate gross domestic product to rise 3.1% in 2018, an upward revision from the 2.8% projection in June. The forecast for 2019 also moved higher by 0.1% to 2.5%.*
- *Fed Powell acknowledged that the US economy was strong and powering ahead, but added that the central bank is hearing a "rising chorus" of concern about tariffs and the U.S.'s turn toward protectionist trade policies. Asked about the pressure from Trump to keep rates low, Powell said the Fed is focused on its mission to keep the economy healthy and doesn't consider politics in the process.*
- *Market reaction was muted, with the Fed latest rate move already fully priced in market valuations (10-yr UST last at 3.04%, $/EUR last at 1.1575 – with the currency pair's drop from 1.1770 largely attributable to negative fiscal development in Italy over the past 24 hours!).*
- *The central banks of Saudi Arabia and the United Arab Emirates followed with similar rate hikes on Wednesday night, with the Saudi Arabian Monetary Authority (SAMA) raising its reverse repo rate from 2.0% to 2.25% and its repo rate from 2.50% to 2.75%, with immediate effect.*

As to the latest update on Trump's trustworthy buddies, it appears that Paul Manafort and Michael Cohen's woes and guilty pleas are from the past now - with a new set of controversies popping up over the past weeks, compelling the public to move onto the next political storm before the last ones have been fully digested! Lately, all attention has focused on the US president's Supreme Court nominee Brett Kavanaugh - and whether Mr. Kavanaugh was indeed responsible for the alleged multiple sexual assaults at high school parties long ago (Judge Kavanaugh has denied Dr. Christine Blasey Ford's accusations before a Senate committee yesterday, claiming "*this is a circus*"). I am guessing the real circus is possibly US Ambassador to the UN Nikki Haley, who claimed on Fox News earlier this week that U.S. President Donald Trump's speech at the United Nations General Assembly only drew laughs because the world leaders in the crowd "*loved his honesty*" and "respect" him.

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