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ECONOMIC REVIEW | May 2017 US FOMC Meeting

Fed Left Interest Rate Unchanged, Views Slowdown in First Quarter as Transitory

- *The Fed decided to leave the federal funds rate in a range of 0.75% to 1.00%. First quarter of 2017 saw GDP grew at annualized rate of 0.7%, indicating a slowdown in the US economy. Consensus of traders and analysts expect a solid growth especially in the second half of 2017. We think that case is likely given that the first quarter data often suffer from seasonality adjustment problem hence a pickup during spring and summer are expected.*
- *Odds for June rate hike increased to 90% - Fed to maintain balance sheet size at the moment. Traders are currently pricing in higher probability for a rate hike by mid-year at 90.0% compared to only 61.1% last week as the market shift its expectation towards rate hike in the second half.*
- *At the moment, we are maintaining our expectation that the Fed will be conducting two more rate hike this year i.e in June and December. Strengthening labour market and core PCE inflation hovering within or above the long-term 2% target as well as solid domestic consumption will enable Fed to gradually on course for rate normalization.*

The Federal Reserve maintained interest rate as expected. The Fed decided to leave the federal funds rate (FFR) target in a range of 0.75% to 1.00%. First quarter of 2017 saw GDP grew at annualized rate of 0.7%, indicating a slowdown in the US economy. The economy expanded by 3.5% and 2.1% respectively in the third and fourth quarters of 2016. Consensus of traders and analysts expect a solid rebound in the economy especially in the second half of 2017. We think that case is likely given that the first quarter data often suffer from seasonality adjustment problem – hence a pickup during spring and summer are the normal expectation.

The Fed Atlanta GDPnow – often a reliable gauge for the next quarter growth is currently pointing towards a 4.2% expansion in 2Q17. We think the US economy will be expanding slightly slower than the Fed Atlanta forecast – between 3.0 to 3.5% in 2Q17 which regardless reflect faster growth compared to the first quarter.

Inflation undershoots in March while jobless rate nears 10-year low. Headline inflation hit 2.4% in March, slightly lower than February's inflation rate of 2.7%. Meanwhile, core PCE – the Fed preferred inflation measure continues to undershoot below its long-term target after falling to 1.6% from 1.8% previously. We opine the risk to downside is high for inflation given the reflation steam in commodities is waning. Brent and WTI crude oil prices have been on down trend amid reports of supply glut globally.

Unemployment rate was down to 4.5% in March, the lowest in almost 10 years despite non-farm jobs only grew by 98,000. Fed noted that other indicators on domestic economy were less upbeat in the first quarter but view the slump as transitory. Note that household spending only grew modestly by 0.3% compared to 3.5% in 4Q16.

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We are maintaining our expectation of two more rate hike in the US this year. At the moment, we are maintaining our expectation that the Fed will be conducting two more rate hikes this year i.e by June and December. Strengthening labour market and core PCE inflation hovering within or slightly above the long-term 2% target as well as firming up of domestic consumption should allow Fed to be on track with its normalisation plan for the year.

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