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ECONOMIC REVIEW | July 2016 US FOMC Meeting

Fed's Optimism is back

- *As expected by most economists and traders, Fed decided to leave its benchmark interest rate at 0.5% in July FOMC meeting. The move has been widely expected since the Brexit vote raised concerns on the global economic growth and financial market stability.*
- *In the latest FOMC statement, all of the pessimism and cautious tone appeared during June FOMC statement has dissipated. Fed mentioned that its labour market has strengthened while economic activity has been expanding at a moderate rate. The Fed went as far as saying that near-term risks to the economic outlook have diminished. However, rather than its domestic economy, we opine that US will be more cautious in increasing its interest rate due to financial market volatility caused by weaknesses in global economy.*
- *July FOMC statement was in line with our previous expectations. Disregarding the EU Referendum result, a September rate hike should have been guaranteed. However, as the global economy has yet to fully assess the impact of EU Referendum result at the moment, we do not think that Fed will conduct a rate hike in September. At the moment we are maintaining our expectation that Fed will keep its benchmark interest rate at 0.5% until the end of 2016.*

In line with expectation, Fed leaves its benchmark interest rate at 0.5%. As expected by most economists and traders, Fed decided to leave its benchmark interest rate at 0.5% in July FOMC meeting. The move has been widely expected since the Brexit vote raised concerns on the global economic growth and financial market stability. As such, we opine Fed will at least wait to see the economic impact from the event before making any move for its monetary policy.

Fed is optimistic with its domestic economy. In the latest FOMC statement, all of the pessimism and cautious tone appeared during June FOMC statement has dissipated. Fed mentioned that its labour market has strengthened while economic activity has been expanding at a moderate rate. Payrolls and other labour market indicators have improved in recent months while household spending has been growing strongly despite business fixed asset investment remain soft. The Fed went as far as saying that near-term risks to the economic outlook have diminished. As an addition, Fed indicated that market-based measures of inflation compensation remain low, after declining in last month.

Fed will continue to reinvest its holdings in debt securities. Fed has clearly stated that they would continue to reinvest the principal payments from its holdings in debt securities which consist of Treasury securities and mortgage-backed securities. It also made clear that they are likely to continue doing so until the normalisation process of the monetary policy is well under way. With this, we are expecting that the earliest Fed will consider stopping reinvesting its holdings in these securities will be in 2019, once they are close to their long term interest rate target.

If not because of EU Referendum result, a September rate hike is guaranteed. July FOMC statement was in line with our previous expectations. Disregarding the EU Referendum result, a September rate hike should have been guaranteed. However, as the global economy has yet to fully assess the impact of EU Referendum result at the moment, we do not think that Fed will conduct a rate hike in September. Furthermore, both the global economy and financial market may take a hit once the impact of the Brexit vote materialises, making it unlikely for Fed to contract its monetary policy this year.

We are maintaining our expectation that Fed will not conduct any interest rate hike this year. Despite the strengthening US domestic economy, we do not think that the strength will continue in the coming months, particularly as the impact of Brexit vote materialises. However, rather than its domestic economy, we opine that US will be more cautious in increasing its interest rate due to financial market volatility caused by weaknesses in the global economy. As such, at the moment we are maintaining our expectation that Fed will keep its benchmark interest rate at 0.5% until the end of 2016.

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