Weekly Flash

FOMC turns more hawkish

MARKET PERFORMANCES (as of June 18, 2021 – 15:20 CET)

	CURRENT	CHANGE 1 WEEK	CHANGE YTD		CURRENT	CHANGE 1 WEEK	CHANGE YTD
S&P 500 Index	4'221.86	-0.41%	12.40%	Gold	1'776.93	-5.32%	-6.36%
S&P/Toronto Stock	20'144.04	0.03%	15.55%	Silver	26.07	-6.55%	-1.19%
EuroStoxx 50	4'096.57	-0.73%	15.31%	Oil WTI	70.64	-0.38%	45.59%
SMI Index	11'958.31	0.99%	11.72%	EUR/USD	1.1874	-1.92%	-2.77%
DAX Index	15'486.67	-1.32%	12.89%	EUR/CHF	1.0946	-0.69%	-1.30%
Nikkei Index	28'964.08	0.05%	5.54%	USD/CHF	0.9218	-2.67%	4.05%
Emerging Market Index	75'911.30	-0.74%	5.88%	USD/JPY	110.3	-0.62%	6.48%
Yield 10Y US Treasuries	1.497	0.0453	0.5823	CAD/USD	0.8076	1.78%	-2.77%
Yield 10Y German Bund	-0.204	0.0722	0.3712	USD/CNY	6.4466	-0.75%	-1.23%

[Source: Bloomberg]

Summary

- The FOMC left rates and bond purchase volumes unchanged, but increased growth and inflation forecasts for the current year.
- The biggest surprise was the updated Dot Plot, which shows a more hawkish rate path, with two hikes expected in 2023.

Monetary policy remains unchanged

At this week's June meeting of the Federal Open Market Committee (FOMC), the Fed funds rate target range of 0-0.25%, as well as the asset purchase policy regime were left unchanged. The policy statement continued to stress the effect of the pandemic on economic activity and was updated to acknowledge further progress on vaccinations. Despite strengthening economic indicators and an improving labor market, the need for continued monetary support was highlighted. According to Chair Powell, Fed officials were "talking about talking about" a reduction of the $120 billion monthly pace of bond purchases, but he made clear that they were not even close to making a decision. Referring to the FOMC's threshold for reducing asset purchases he added that "The economy has clearly made progress, although, we are still a way from our goal of substantial further progress".

Projections for 2021 raised

The Summary of Economic Projections (SEP) showed materially higher estimates for real GDP and inflation for 2021. Median projections were increased from 6.5% to 7.0% for GDP growth, and from 2.2% to 3.0% for core inflation. The median unemployment projection for 2021 was unchanged at 4.5%. Medium-term activity projections moved higher, with the GDP growth median for 2023 up two tenths to 2.4%. Estimates for core inflation rose by 0.1% to 2.1% for 2022, but projections for 2023 remained stable at 2.1%, with only one participant increasing his individual forecast. In the press conference following the FOMC meeting Powell again stressed that rising inflation is still considered as transitory, but that there is a certain risk that inflation may be higher than originally expected.

More hawkish monetary policy path

FOMC members updated their median projected path for the policy rate from zero to two rate hikes in 2023, which was the biggest surprise of the meeting. A total of 13 members now expect a 0.25bps hike in 2023, and 11 members expect at least two hikes that year. The median dot thus shifted higher and is now in line with market expectations, which were already pricing an earlier lift-off than the Fed before the meeting. This marks a clear shift in the Fed's thinking on rates and the market is now also likely to anticipate an even more pronounced hiking path for 2023. Our own expectation was for tapering during 2022 and a potential first rate hike in 2023. After the FOMC meeting and against the background of the updated Dot Plot we see the likely start of the hiking cycle rather in the first part of 2023 than later.

Conclusion

The FOMC left the funds rate target range as well as the monthly asset purchase volume unchanged. The new policy rate projection shows two rate hikes in 2023 despite almost no change in 2022 and 2023 core inflation forecasts. The FOMC seems to view the current inflation overshoot as largely sufficient to accomplish its average inflation target. In our view, this lowers the inflation bar for potential rate hikes further down the road. Important in that respect is not actual inflation during the course of 2021, which is expected to be considerably above 2% on strong base effects. More important are inflation expectations for 2022 and 2023, which are currently anchored around 2%. If these expectations would rise considerably above 2%, this would likely trigger a more hawkish reaction of the Fed, with negative short-term implications for risk assets. We are not there yet.