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ECONOMIC REVIEW | February 2017 US FOMC Meeting

Fed Hints the US Economy Gains Further Traction but Leave Rate Unchanged

- *Officially this is the first interest meeting in the Trump Era. 10 voting members voted to leave fed funds at target range of 0.5% to 0.75% during the February meeting, as have been widely expected by economists and market alike. The fed officials pencilled three rate hikes for this year in last December but the market expects the Fed to raise only twice i.e in June and December respectively.*
- *At the moment, we are maintaining our expectation that the Fed is going to increase its interest rate twice year i.e by June and December. However, we think the risk to the downside is bigger as it remains a big challenge for Trump to deliver his remaining campaign manifesto in the next few quarters especially on fiscal matters i.e infrastructure spending and tax cut due to limitation on the fiscal front. Hence, should those matters do not materialize in the future, the Trump US equity rally and higher inflation expectation could fall in drove.*

The interest rate was left unchanged as widely expected. Officially this is the first interest meeting in the Trump Era. 10 voting members voted to leave fed funds at target range of 0.5% to 0.75% during the February meeting, as have been widely expected by economists and market alike. The fed officials pencilled three rate hikes for this year in last December but the market expects the Fed to raise only twice i.e in June and December respectively.

Household spending continued to rise and inflation increased but still low. As compared to December FOMC meeting, the Fed opines that the household spending continued to rise from 'rising moderately'. We concur that inflation increased, though we opine that it was mostly due to the increasing oil price rather than the due to an upward inflationary pressure coming from a strong economy. Recall that the first half of 2016 oil prices were low especially the first quarter which average circa USD35pb. Interestingly, the fed adds the word 'will' to its latest inflation statement which points that the Fed is having great confident that inflation will rise above 2% in the medium term. While we think this is possible, we believe the US economy is facing great deflationary headwinds due to aging baby boomer population which will start to save more of those cohorts hit retirement.

Fed takes President Trump slightly off the center stage with this meeting but we think it will only be so temporarily. The market's gyration will remain with the President as he unfolds more decisions that will have real repercussion on trade and investment globally. So far, Trump has been somewhat ahead of expectation, especially with his executive order signing to hasten the pace of building the Mexican wall. The blanket border tax and high tariff if implemented should be negative to globalisation and world economy.

We are maintaining our expectation of two rate hike this year. At the moment, we are maintaining our expectation that the Fed is going to increase its interest rate twice year i.e by June and December. However, we think the risk to the downside is bigger as it remains a big challenge for Trump to deliver his remaining campaign manifesto in the next few quarters especially on fiscal matters i.e infrastructure spending and tax cut due to limitation on the fiscal front. Hence, should those matters do not materialise in the future, the Trump US equity rally and higher inflation expectation could fall in drove.

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