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US central bank confirms trend reversal

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We have seen a number of trend reversals this year, one of them being the end of the negative growth surprises. The forecast of economic growth and inflation are currently not subject to downwards revisions any longer.

Estimates revised upwards

The US Fed provided a case in point at the FOMC meeting on 14 December. The estimates of economic growth in the USA were increased from 1.8% to 1.9% for 2016 and from 2.0% to 2.1% for 2017. Along with this revision, the future path of the key-lending rates has also been revised. For the end of 2017, the median of the estimates by all the members of the FOMC is now at 1.4% (previously 1.1%); for the end of 2018, it amounts to 2.1% (previously 1.9%), and for the end of 2019, it is 2.9% (previously 2.6%).

Interest rate increase as formal act

The increase of the Fed funds rate of 0.25 percentage points to 0.5-0.75% was merely a formal act. The market participants had been prepared for that move in the previous weeks, as a result of which a higher Fed funds rate was already fully priced in.

US bonds record yield increase, US dollar appreciates

In response, the yields of government bonds have increased, while the US dollar appreciated relative to other currencies. The market had to digest the steeper path of the future Fed funds rate. Are there any factors that suggest continued movements on the market? Firstly, the market has currently a Fed funds rate of about 1.19% priced in for the end of 2017, not 1.4% as suggested by the Fed. Secondly, the revisions are of a cyclical nature: one is often followed by another one.

Stabilisation?

What are the factors suggesting a stabilisation of the market? The press release by the Fed and the press conference by chairwoman Yellen were moderate in tone. Yellen described the revisions of economic growth and of Fed funds rate forecast as limited. In the statement, Yellen referred to consumption growth as “moderate” and to capex in the corporate sector as “weak”. Remarkably, from the Fed’s point of view the short-term risks for the economic outlook are balanced. By contrast, the market has priced in upside (i.e. positive) risks. The statement was therefore not generally hawkish, i.e. not rooted in the fight against excessive levels of inflation.

A lot is already priced in

In addition to the end of the growth disappointments, another important data point emerges for the assessment of the future market movements. The market prices already reflect a significant share of the expected improvement on some levels such as economic growth and inflation.

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