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Flash Macro Update (03/20/2019)

FED's FOMC meeting ended with dovish messages that were welcomed by the fixed income market mostly. According to the short statement of the FOMC meeting, FED decided on keeping its benchmark funds rate unchanged in a range of 2.25% to 2.50% as expected. Since that decision was universally expected, it did not have an impact on financial markets. But FED's other messages and forecasts were more dovish than expected and they affected pricings in financial markets.

Market players were looking at two things: Dot plot and speed of balance sheet runoff. Regarding the first one, new dot forecasts indicated that instead of two hikes throughout 2019, FED members now do not expect a rate hike in the remainder of 2019. While some members foresee that a hike will be necessary in 2020, the pause of rate hike cycle for 2019 was enough for a rally in markets. EUR & gold reacted positively; EMFX reacted positively and all fixed income markets reacted positively to the forecasts.

In addition to the rate decision and projection, FED also commented on the speed of the balance sheet contraction. FED now thinks that the balance sheet runoff will slow down in May and will be completed in end-September. FED was planning to reduce its balance sheet by US$30 bn every month, which will now be revised to US$15 bn after May. We calculate that FED's balance sheet contraction will end somewhere around US$3.7 trn compared to previous expectations of around US$3.5 trn.

Markets for now preferred to ignore the reason why FED members trimmed their rate hike expectations. FED clearly stated that the labor market remains strong, but growth of economic activity has slowed from its solid rate in the fourth quarter. Although the economic outlook is still positive, FED members naturally expect a slower economy (at around 2%) in the remainder of 2019. On the inflation front, FED blamed lower energy prices for the decline in annual inflation. FED emphasized that on a 12-month basis, overall inflation has declined, largely as a result of lower energy prices.

After the FOMC decision, FED Governor Powell held a press conference. At the conference, Powell reiterated FED's patience on the rate front and defended FED's current 'wait and see' approach. The messages of the conference were not that different than the FOMC statement. But it is worth noting that Brexit and trade negotiations are mentioned as risk factors. FED's next FOMC meeting will take place on Apr30/May1.

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