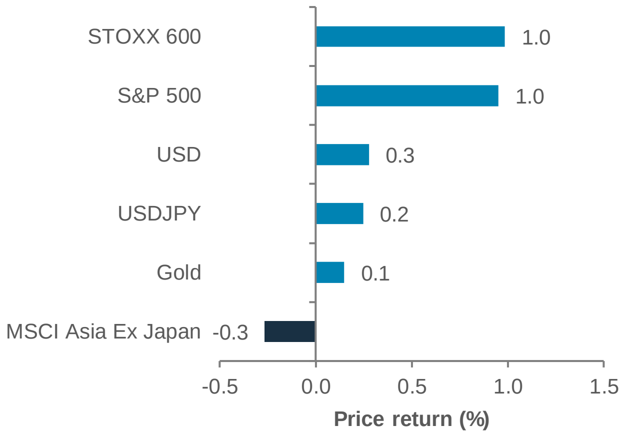
Market Watch

FOMC – A Hawkish Tilt

US equity markets up after the Fed statement

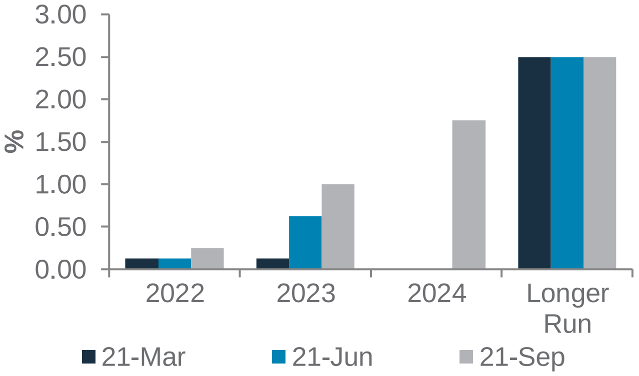
1-day price return (%) on September 23



Source: Bloomberg, Standard Chartered

Sooner-than-expected interest rate hikes

Projected median US Fed funds rate (based on Fed dot plot)



Source: Bloomberg, Standard Chartered

Summary

The US Federal Reserve reiterated its confidence in the growth recovery and signalled it could announce tapering as soon as November, aiming to complete the process by mid-2022.

US equity markets rose on Wednesday with the S&P 500 index up 0.95% in a relief rally. However, the Fed signalled interest rate increases may follow sooner than expected, boosting the US dollar.

The Fed's upgraded, above-trend 2022 and 2023 growth projections reflect optimism in the economic recovery. We maintain a preference for global equities over bonds on a 12-month horizon.

Background

The US Federal Reserve has been preparing markets for an eventual withdrawal of its pandemic-induced asset purchase program, while reassuring that any reduction was not a precursor to an imminent interest rate hike.

At yesterday's Fed meeting, the US Federal Reserve stopped short of announcing a dialling back of its asset purchase program this month. However, at the post-meeting news conference, Powell signalled tapering could be announced at the November policy meeting as long as jobs growth through September is "reasonably strong".

However, the Fed's 'dot plot' showed that 9 of 18 Fed officials are ready to complete the first interest rate hike by end-2022, compared with 2023 previously. The projections show 3 more hikes are expected for both 2023 and 2024. This likely drove US dollar gains against the euro. Risk-sensitive currencies like AUD and NZD were off highs. Gold was down, but the US 10-year Treasury yield fell.

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What does this mean for investors?

We don't see the Fed statement, particularly the interest rate projections, as negative for risk appetite. Indeed**, we view it as a reflection of the Fed remaining confident in the US economic recovery,** despite a slowdown in growth in Q3 and job creation in August due to a COVID-19 resurgence. The Fed believes its inflation goals have been met, with Powell reaffirming this view.

Tapering is likely to start by November or December and expectations of the first interest rate hike by end-2022 are likely to increase. Powell's comments that tapering will be completed by the middle of next year suggests the Fed is considering tapering purchases by USD 15bn a month from the current buying pace of USD 120bn a month. While this pace is slightly faster than previous market expectations, it ties in with the new "dot plot" projections by Fed policymakers which now show that half of the policymakers expect the first rate hike by end 2022.

As a result, we maintain our preference for Equities over bonds. Within equities, we prefer US and European stocks which are benefitting from a relatively faster pace of vaccinations (leading to early economic re-opening and strong upgrades to corporate earnings estimates). We expect the US dollar to give back some of its recent gains, barring a significant surprise in Chinese property markets and the upcoming German elections.

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