



بنك الإمارات دبي الوطني  
Emirates NBD

## US Rates 25 February 2018

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# Interest Rate Monitor

**US rates continued to remain volatile with short-end yields rising in anticipation of upcoming rate hikes and belly of the curve flattening somewhat.** Yields on 2yr, 5yr, 10yr and 30yr UST's increased to 2.24% (+5bps), 2.62% (-1bp), 2.87% (unchanged) and 3.16% (+2bps) during the week. This is hardly surprising as, historically, rate curves tend to flatten mid-way during cycles of synchronized global growth and high expectations of monetary policy tightening.

**The key event of the week was the release of the January FOMC Meeting Minutes and the Statement of Longer-Run Goal and Monetary Policy Strategy which were perceived to be slightly hawkish.** Given that the FOMC meeting comments pre-date the recent congressional agreement to boost spending, the overall mix of fiscal stimulus could be significantly bigger over the next 18 months than was assumed at last month's FOMC meeting. **Market implied probability of rate hikes in 2018 still remains at 3 hikes this year but has now increased from one to one and half for 2019. Market participants expect an even possibility of upward revision to Fed's dot plot projections at the March FOMC meeting.**

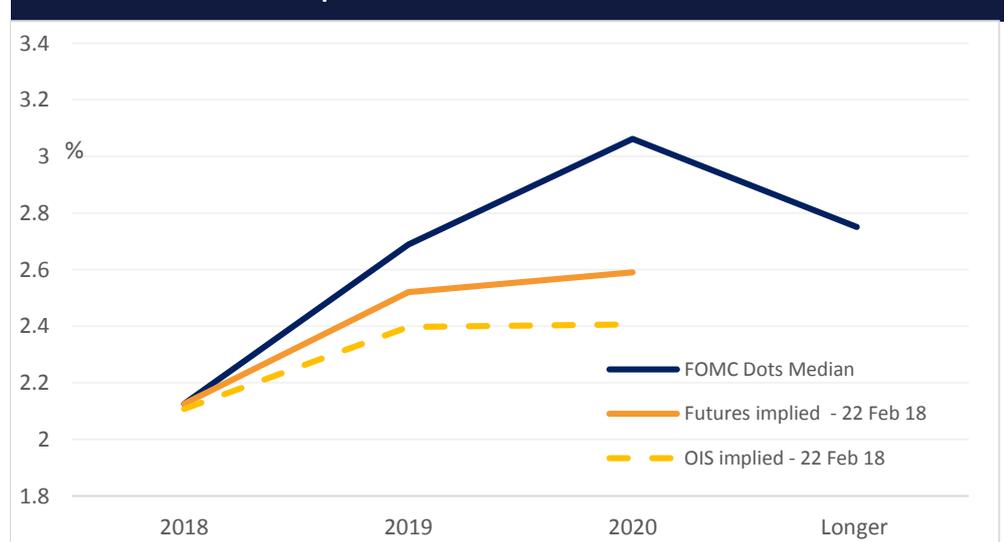
## Fed Watch

The minutes of FOMC meeting revealed that the Committee expects that the economic conditions will evolve in a manner that will warrant **further gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.**

Also in FOMC's statement of **Longer-Run Goals and Monetary Policy Strategy**, the committee affirmed its judgment that inflation at the rate of 2%, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate. **Fed officials projected that core inflation would reach 2% in 2019 and that total inflation would be at the Committee's 2% objective in 2020.** Recent developments had increased their confidence in the outlook for further progress toward the Committee's 2% inflation objective.

In terms of unemployment, it was noted that the FOMC committee does not find it appropriate to specify a fixed goal for employment; rather, the Committee's policy decisions must be informed by assessments of the maximum level of employment, recognizing that such assessments are necessarily uncertain and subject to revision. That said, in the most recent projections, **the median of FOMC participants' estimates of the longer run normal rate of unemployment was 4.6% down from 4.8% in January 2017.**

FOMC Dots vs market expectations



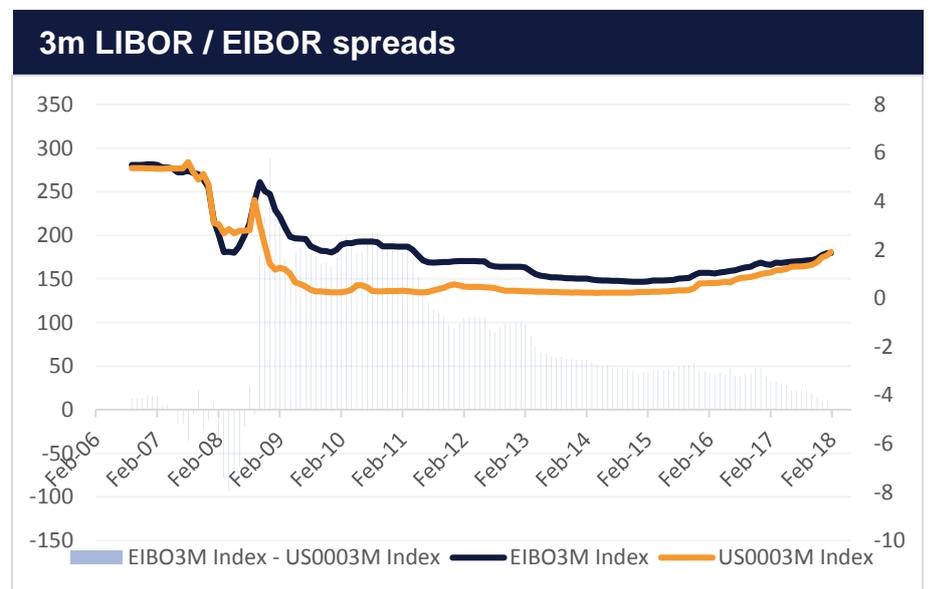
Source: Bloomberg, Emirates NBD Research

Market focus has now shifted to speculating if the Fed is underestimating the strength of the US economy and inflation. Investors have begun to question if three rate hikes in 2018 are too little and have begun to analyse Fed speaker’s language and speeches for signs of upward risk to the current dot plot trajectory.

- Federal Reserve Bank of San Francisco President John Williams said he favors three or four interest-rate increases this year and policy makers should make a move soon. In contrast, Fed President Bullard (non-voter) said he is sceptical the economy needs four rate hikes, it would seem like “a lot to me” he said. Fed President Kaplan (non-voter) said that three U.S. interest-rate increases in 2018 is a “reasonable” base case.
- Federal Reserve Bank of Cleveland President, Loretta Mester (voter) said that she remained open-minded about considering raising the inflation target from 2% to 4%, however, the success of the current framework means that the bar should be high for making any change to the framework.
- Fed Chair Powell will deliver the Fed's semi-annual monetary policy testimony to Congress on Tuesday. He is expected to project confidence that inflation will rise, that activity will accelerate, and that the FOMC will gradually raise rates, while possibly mentioning the importance of longer-run fiscal sustainability.

### GCC Local Rates

Though absolute level of interbank rates in the UAE have risen in line with higher US rates, the spread between 3m EIBOR – LIBOR rates has reduced from a high of around 213bps in early 2009 to -6bps now.



Source: Bloomberg, Emirates NBD Research

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