

Market Bulletin

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Policy normalisation – See you in December?

There was no change in policy at yesterday's US Federal Reserve's (Fed's) meeting, but there were a few changes in the language of its statement. The emphasis on international developments lessened slightly and the Fed seems to be moving towards more frequent updates on the status of the US economy, rather than focusing on its longer-term views about the potential growth of the economy. This supports our theory that the Federal Open Market Committee (FOMC) may be waiting for the momentum in economic data to improve, rather than judging the overall health of the US economy in relation to its potential.

The majority of reactions from Fed-watchers will likely focus on the Fed's treatment of its sentence about the beginning of policy normalisation. At the September meeting, the sentence read, "In determining how long to maintain this target range, the committee will assess progress-both realised and expected..." Now it reads as follows: "In determining **whether it will be appropriate to raise the target range at its next meeting**, the Committee will assess progress..."

While this seems to signal a possible rate hike in December, it is not really a material change from the Committee's line for the past two months. The Fed is simply reiterating that it could begin policy normalisation at any future meeting, and is seeking to prepare investors by striking a more hawkish tone. Our view remains that the FOMC requires just a little more confidence that the data will continue to improve to give it the final push towards raising rates.

After its much-discussed notation of global developments in the last statement, the Fed deemphasised its focus on events abroad. The October statement removed the sentence that read, "Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." However, the Committee kept the caution that it would be watching the rest the world by changing "The Committee...is monitoring developments abroad" to "The Committee...is monitoring global economic and financial developments."

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The Fed made a few other updates to its assessment of the US economy:

- Language on the improvement in household spending and business fixed investment changed from "expanding at a moderate pace" to "expanding at a solid rate"
- The Fed noted further improvement in the housing market
- On the labour market, the statement now reads that the "pace of job gains slowed," but maintains that labour market slack has diminished
- The Committee emphasised a slight move lower in measures of inflation compensation

All in all, the Fed's assessment of the US economy improved slightly. Furthermore, the somewhat more hawkish tone struck by the Committee certainly aims to prepare investors for an eventual increase in rates and to highlight that every meeting from here onward is a potential date for lift-off. The impending start of policy normalisation suggests a continued overweight to risk assets relative to high-quality fixed income, within the context of a balanced and diversified portfolio. In addition, investors should prepare for an increase in volatility as markets adjust to rates moving off of the zero lower bound for the first time in almost seven years.

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