LATEST HEADLINES FROM ANZ MORNING FOCUXS

No Change

Friday, September 18th 2015,

ANZ's economists all get out of bed early to hear what the US Federal Reserve had to say this morning about interest rates and the economy.

This morning's US Federal Reserve meeting was billed as the must see event of the decade, but in the end it was a bit of a fizzer, with policy left on hold and the Fed's so called "dot plot" projections for the Fed Funds rate lowered by 25bps across the board. In hindsight, I'm sure many a trader is now ruing their decision to get out of bed and come in early (we had a full complement on deck here at 5.45am!).

But hang on – not so fast. A lot did happen, and when you have an event that is painted as the must-see thing, and then you don't see anything, that has news content.

For one, we know that the Fed is still keen on lifting the Fed Funds rate, and at the press conference later on, Yellen specifically said that October was a possibility, and that they expect to start hiking this year.

So in terms of timing, we are talking about a slight delay, provided things evolve as expected. Beyond the sticker shock of the no-go decision, the implications for this are very limited, and should really only affect the very short end of the US yield curve.

Three other things also came out of the statement, and various comments that were made at the press conference that followed.

The first was the Fed's somewhat cautious tone on inflation, which it had noted remained below the Fed's target (it also noted that inflation expectations had also declined). Consistent with the Fed maintaining "a balanced approach", this strongly suggests that we cannot ignore inflation and only focus on the jobs market. Indeed, while unemployment continues to fall, core PCE inflation – the Fed's preferred measure – continues to fall too.

Second, the Fed has specifically said that it is "monitoring developments abroad", clearly signalling that it is cognisant of the implications of their actions abroad and in markets, which have been volatile. At the margin, this is indicative of a more cautious approach (i.e. more moderate than otherwise tightening).

Third, and in our view, most importantly, the Fed has lowered its Fed Funds track and its long term central tendency expectation for the Fed Funds rate by 25bps (from 3.75% to 3.5%). If this were gospel, it would, all else equal, imply that the long term funding rate for owning financial assets has just declined by a quarter of a percent. That should be good for all assets, especially equities and long dated bonds, and especially as it would seem that it is the low inflation environment that prompted the change.

If the Fed was backing away because it was looking for activity to improve, or was going soft on inflation, we'd be worried. But it is not, inflation is going soft on the Fed, and since inflation is the biggest bogey man of all for bonds, and is absent, we think it's bond-positive.

That said; market expectations are already well below the Fed's dot plots anyway, so perhaps we should not over-emphasise this point. But net on net, it is positive for bonds and it should, at the margin add upside pressure to currencies like the NZD that have been relying on a stronger dollar to deliver some depreciation.

Source: ANZ Morning Focus