Article | 16 September 2020

Rates Spark: no-FOMO FOMC day

Today's FOMC is the last one before the US presidential election, so don't expect anything that can have a meaningful political leaning. That said, we think the 2023 "dot" and inflation forecast can, potentially, be market moving. In Europe, Lane is due to talk again. EUR rates are already pricing a cut and would struggle to price more.

Source: Shutterstock

What to look for from the Fed today? Still a steepening bias

We'll be watching two key items from the FOMC outcome. First, the posting of an end-2023 dot is mooted. The odds heavily favor a replication of 2022, 2021 and 2020 i.e. no change from where we are today. Last time there were a couple of dots above current levels for 2022, and we'd likely see that again in 2023, perhaps joined by another one or two. That would suggest a bit of a debate on where the turning points for rates could be.

The overall impression from the dot plot outcome should be to leave the markets with the firm impression that the front end is absolutely anchored. That brings us to the other key element - will there be any uplift in the inflation forecast? As it is the Fed has long run inflation at 2%. The question is would they dare to throw in an above 2% inflation number - a nod of acknowledgement towards the average inflation target mandate that they have taken on.

Even if there is no explicit inflation forecast uplift, the fact that the Fed has moved to average inflation targetting is still a big deal.

> *"Yes, just saying it is not enough to generate inflation. But then again, saying it is still different from not saying it."*

There is much speculation on whether the Fed will be more specific on what average inflation targeting will actually entail. We are of the opinion that participants will be disappointed on that front. Ultimately the Fed does need some flexibility at turning points; suffice at this juncture to assert that if or when we get to that point where inflation is running at above 2%, the Fed will not be panicked into a pre-emptive rate hike.

So far the long end is betting that a break above 2% is unlikely. Probably right, but risk/reward also suggests that more insurance should be taken out in ultra-long exposures. That's why curves are upward sloping in the first place - we just don't know for sure out there.

We still think the curve should be steeper, not dramatically, but just a tad to acknowledge the existence of inflation average targeting.

We don't expect anything big though. It's the last FOMC before the election; not the time to be a discussion point from a political perspective.

No pre-FOMC FOMO for EUR investors

For once, EUR investors might not be affected by their FOMC-day FOMO (fear of missing out). Three ECB speakers are lining up for today's session. Two of them, Lane and Holzmann sit at opposite ends of the dove-hawk spectrum. The former, incidentally the ECB's chief economist, has been particularly vocal before and after the September meeting to highlight the downside risks a higher EUR exchange rate poses to the inflation outlook.

Hard as he has tried, Lane has failed to land a durable blow to the common currency. Since his latest outing raised the spectre of additional rate cuts, he is likely to receive increased attention from rates investors however. Truth be told, EUR money markets are already pricing a non-negligible chance of easing next year which would dampen the rate market impact of further comments raising the possibility of a cut.

We will let our FX strategy colleagues address the efficacy a 10bp cut in the deposit rate on the currency. From the point of view of rates markets, we think their ability to anticipate further cuts will be limited as central bank officials have flagged the proximity of the effective lower bound. More importantly perhaps, investors might be tempted to question the wisdom of another deposit rate cut to stem a temporary rise in the EUR when the ECB has had no opportunity to subsequently tighten policy.

Today's events: FOMC, German supply, ECB speakers

In addition to this evening's FOMC meeting (see preview above) and to the ECB's speakers (ditto, Hernandez de Cos completes the trifeca), Germany sells 30Y debt today.

Author

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com