

OVERVIEW

This is only a single speech and, while it is important, it is not policy setting. This speech focused on financial stability but has implications for monetary policy.

- Chair Powell stated that policy rates are “just below” neutral.
 - **COMMENTARY:** We finally agree on something. Neutral is around 2.75% and (probably) will not move much higher.
- Chair Powell does not think stocks are a risk to financial stability.
 - **COMMENTARY:** The Fed should have avoided opining on stocks. This might be a poor precedent.
- Chair Powell does not want to raise rates in a way that would shorten the U.S.’ economic expansion.
 - **COMMENTARY:** Good luck without a pause.
- Chair Powell does not see significant risks to growth next year.
 - **COMMENTARY:** He cannot say the economy is slowing, but that is between the lines.

COMMENTARY AND FALLOUT

The US dollar and yields are lower following the release of the text. Most of the decline in yields is on the short end of the curve, as additional rate hikes become less likely in 2019. The long end of the curve is relatively flat. The US dollar decline is across the board, but there is a large decline against the euro. This is likely due to the slowing divergence of monetary policy between the Fed and ECB (the ECB is likely to announce the end of QE next month). The dovish sentiment in the text of the speech is likely to lower expectations around more than 2 hikes in 2019 and increase the chances of a pause. The reason for the sharp reaction of risk assets is the feedback loop of a weak dollar and relatively dovish Fed. The feedback loop being: a weak dollar feeds through to developed and emerging markets growth expectations, commodity prices, US corporate earnings, and so on.

Our base case of 2 hikes in 2019 is likely to be where the market lands following this speech. December remains odds on for a hike and we agree. That makes for 3 total hikes with a 3% end point.

This is subject to change with the next Fed speech.

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