Fed kicks off Super Thursday by signalling 50bps of hikes by 2023

The US Federal Open Market Committee kept its key policy settings broadly unchanged, holding its policy interest rates in a 0.0% to 0.25% range (with the rate the Fed paid in bank reserved raised to 0.15% for technical reasons) and maintaining QE at a USD120bn monthly pace. Moreover, there were no forward guidance changes to the fed funds rate and asset purchases. **However, what causes a stir in markets was the admission by the Fed that the period of ultra-low interest rates was unlikely to continue forever, considering the brighter signs in the US economy.** This is a message that other central banks (including the RBA) will have taken note of.

The Fed 'dot plot' interest rate projections were tweaked up, with 50bps of hikes priced in for 2023, consistent with market pricing. The shift in the plots was noticeable, with a 13-5 split for hikes in 2023 (7-11 in March) and just a 11-7 split in favour of no change in 2022 (from 14-4). Moreover, at the Press Conference FOMC Chair Powell acknowledged that the Fed had begun a discussion about tapering bond purchases, noting "the economy has clearly made progress."

The Fed's near-term GDP economic forecasts were revised up, with GDP (to 7.0%, 3.3% and 2.4% in 2021, 2022 and 2023) with little change to the unemployment rate forecasts (4.5%, 3.8% and 3.5%). Core PCE inflation forecasts were revised up for 2021 (3.0% versus 2.2% in March), but subsequent forecasts were anchored around 2% (2.1% for 2022 and 2023), consistent with the Fed's 'transitory' view of current high inflation.

Market reaction to the Fed was swift, particularly in the Treasury market. US Treasury yields jumped, led by 10bp increases in the 5- to 7-year part of the curve (10y 1.56%). The USD index rose close to 1%. US Equities (S&P500) dipped but have subsequently climbed to pre-announcement levels.

Prior to the Fed, investors had been marking time with modest moves in US stocks, Treasury yields, and the USD. European stocks crept higher overnight, whereas Asian stocks were generally lower (NZX 50 -0.9%). Government bond yields were fractionally lower in Europe, with a curve flattening bias. Australian bond yields were a touch firmer with a curve steepening bias, whereas NZ yields were little changed. Commodity prices were little changed and look to have largely ignored measures by Chinese authorities to limit the exposures of Chinese SOE's to overseas commodity markets.

Data wrap: UK May CPI (headline CPI 2.1% yoy versus mkt: 1.8% yoy, core CPI 2.0% yoy versus 1.5% yoy) were firmer than expected but bang on with the BOE's inflation target. US housing starts (1572k versus mkt: 1630k) and building permits (1681k versus 1730k) undershot expectations, while stronger-than-expected import (+0.9% mom) and export prices (+2.2% mom) highlighted pending pricing pressures. Chinese May monthly retail sales (12.4% yoy versus mkt: 14% yoy), industrial production (8.8% yoy, 9.2% yoy) and fixed asset investment data (15.2% yoy, 17% yoy) mildly undershot expectations.

Local Wrap: There was virtually nil market reaction to the NZ Q1 current account figures, which showed a widening in the annual deficit to $7.2bn in the March 2021 year (2.2% of GDP). Courtesy of rising global equity values, NZ's international investment position fell to 49.5% of GDP, its lowest on record. There was little reaction after the RBNZ announced debt serviceability restrictions (DSRs) to mortgage lending would be added to their macro-prudential policy toolkit. The RBNZ are likely to decide in the coming months whether to deploy this tool, which in our view is less effective than OCR hikes in bringing greater balance to the housing market.

FX comment: The USD index jumped after the Fed announcement pushing the NZD down by close to 1 US cent, with the NZD currently towards the bottom of its 0.7040 to 0.7160 USD overnight range and through its previous a 0.7120-0.7130 USD support level. The AUD didn't fare much better, with the NZD gaining slightly against the AUD overnight (0.928). Despite the NZD falling through key support levels and liable to further weakness against the USD, we remain constructive of the NZD outlook given our upbeat commodity price and NZD interest rate view.

Day ahead: Busy. We expect NZ GDP to start Q1 on a solid note (ASB:+0.8% qoq. Mkt: +0.5% qoq, RBNZ: -0.6% qoq). Just after midday is a speech by RBA Governor Lowe ("From Recovery to Expansion") that will be examined for clues ahead of the key July policy decision. At 1.30pm is the Australian May labour market report, where our CBA colleagues expect a 20k increase in employment (mkt: +30k), with the unemployment rate to ease to 5.4% (mkt: 5.5%). Later today, NZDM will tender $300m of NZ Government bonds (2024, 2029 and 2037 bonds). Tonight, has Eurozone May CPI (headline 2% yoy, core 0.9% yoy), the June Philly Fed and initial (mkt; 360k, prior: 376) and continuing claims (3425k, 3499k), which are expected to highlight the ongoing US labour market recovery. **Author**: mark.smith4@asb.co.nz

Currencies			Currencies			Commodities			Equities		
NZD/USD	0.7065	-0.8%	NZD/SEK	5.975	0.8%	NZX WMP	3890.0	-1.3%	Dow	34071	-0.7%
NZD/AUD	0.9269	0.0%	NZD/DKK	4.375	0.2%	Gold $/o	1832.5	-1.4%	S&P 500	4232	-0.3%
NZD/EUR	0.5883	0.2%	NZD/THB	22.1	-0.4%	WTI Oil $/b	72.2	0.0%	NASDAQ	14061	-0.1%
NZD/JPY	78.13	-0.3%	AUD/USD	0.7622	-0.8%	**Money Market (%)**			FTSE	7185	0.2%
NZD/GBP	0.5046	-0.3%	EUR/USD	1.201	-1.0%	90 Day BB	0.32	0.00	CAC-40	6653	0.2%
NZD/CAD	0.8654	-0.3%	USD/JPY	110.6	0.5%	OCR	0.25	0.00	DAX	15711	-0.1%
NZD/CHF	0.6414	0.2%	**10 Yr Bond Yields (%)**			**ASB Swap Rates (%)**			H.Seng	28437	-0.7%
NZD/HKD	5.484	-0.8%	NZ	1.66	0.02	1yr	0.36	0.00	Nikkei	29291	-0.5%
NZD/SGD	0.9434	-0.2%	US	1.57	0.08	2yr	0.54	0.01	ASX200	7386	0.1%
NZD/CNH	4.548	0.2%	Aust	1.56	0.05	5yr	1.20	0.01	NZX50	12582	-0.9%

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