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Market Update: 10th June 2020

US Jobs Data Surprises Ahead of Fed Rate Decision

Markets remained volatile this week as investors await the Fed's June rate announcement, with investors watching closely for any indications on further stimulus and expectation for future rate movements. As the US economy grapples with the coronavirus pandemic and its impact on activity, all eyes remain on the Fed and its efforts to support the economy through this period of weakness.

Market Expectations

On the conclusion of the latest two-day meeting of the Federal Open Market Committee (FOMC), US policymakers are expected to keep the funds rate steady at a range of 0-0.25% and leave policies largely unchanged. The central bank is expected to re-commit to using the full range of tools to support the US economy and discuss forward guidance. After taking the unusual step of suspending forecasts in March because of virus uncertainty, policymakers will publish updated economic forecasts for the first time since December, including the so-called dot plot of funds rate projections. The Fed's last rate forecast in December had a median rate of 2.125% at the end of 2022, however that outlook was swept away as the pandemic hit in March and the Fed subsequently slashed rates to deal with the economic fallout. Federal Reserve policy makers will today be considering pencilling in interest rates near zero for this year and next to help the US economy recover, with expectations that the Fed will raise rates only in 2022.

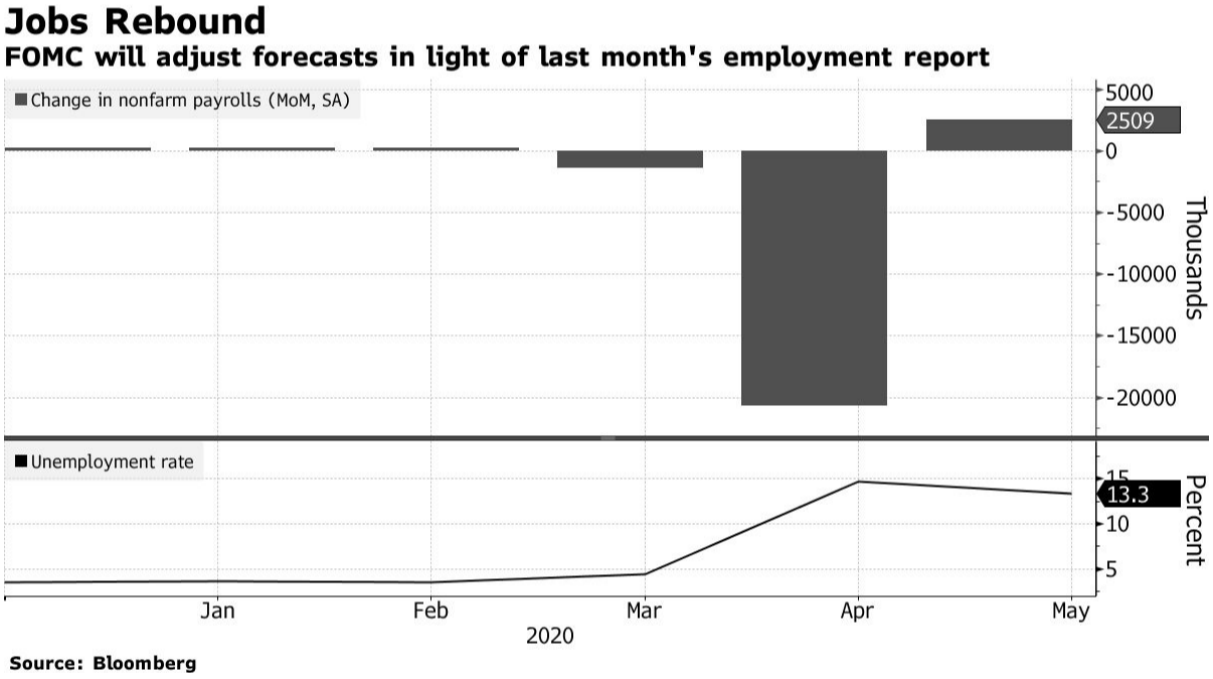
Investor Expectations

Investors will be anxious to see Fed rate projections, though Fed Chair Jerome Powell is likely to emphasise current uncertainty on the projections, and is unlikely to commit the central bank to any unexpected movements given current economic conditions. Investors will be looking more specifically for any mention of yield curve control (although it is probably too soon to see) and for any changes in the bank's quantitative easing program and balance sheet. Possibly the most impactful announcement to come out of today's meeting would be details on further quantitative easing. The Fed is currently purchasing Treasuries and Mortgage-backed securities in amounts needed to ensure smooth market functioning. Analysts expect that the Fed will reformulate the program in the coming months along the lines of its large-scale bond buying from 2008-2014 to stimulate economic activity. We could see developments on this issue today, or the committee may look to evaluate the current strategy at a later date.

In the last press conference in April, Powell made a strong argument in favour of additional spending by Congress to help offset the effects of the recession. He may look to step up this pressure again in the press conference later this afternoon, particularly for states dealing with social unrest and what could be a rise in Covid cases. Any delays to the reopening and fear triggered by social unrest and heightened risks of contagion would warrant further government support and would be received well by investors.

Jobs Data

Better than expected May unemployment data announced on Friday point to the economy being past the worst as it slowly reopens. The US economy unexpectedly added 2.5 million jobs in May, the most on record, beating expectations of an 8 million fall after declining by a record high of 20.7 million in April. May unemployment unexpectedly declined to 13.3%, defying expectations for a Depression-style surge in joblessness and stoking optimism that the economy is bouncing back from a virus-induced recession.



According to research by the St Louis Federal Reserve, the US labour market has continued to heal at a relatively rapid pace through early June, using real-time data that provides a more timely view than official government reports. The research shows that employment fell by around 8.75% in the week ended June 5th from January levels, making up almost half of the 15.08% decline reported in mid-April. The data show that some states are recovering at varying rates as they slowly reopen, however overall, the recovery is taking place at a relatively healthy pace.

The numbers are encouraging and point to a bottom in April/May, however the Fed will likely be very cautious in interpreting them. Joblessness is projected to decline in the coming months and years as the labour market heals, while the Fed's inflation forecasts are likely to be lowered in light of the recent drop in economic activity and fall in oil prices. Despite the encouraging jobs data, at this stage the Fed is not expected to signal it is anywhere near exiting from emergency policies to keep credit flowing as it monitors what officials have warned will be a slow road back to normal.

Our Expectations

Although we don't expect anything new to be announced in today's press conference, we will be looking closely at the language used by Chairman Powell to describe the outlook and future rate expectations. It is our view that central banks will remain highly accommodative for the foreseeable future as the recovery continues. Forecast figures are expected to be bleak, however the Fed is likely to soften the blow with a more upbeat outlook and a longer term outlook for recovery. Data continues to highlight a tremendous amount of slack in the system, with capacity and demand returning quickly as the economy reopens. Although encouraging for the medium term outlook, the May employment bounce is unlikely to have an impact on the Fed's policy at this early stage, and it is our view that the discussion of the policy exit from emergency programs remains premature until the economy recovers closer to pre-crisis levels.

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