

Fed Watch

March preview: Substantial "dot migration"

Rates should be kept unchanged at the March FOMC meeting, and Chair Powell is likely to stick to the keyword of "patience" when describing the Fed's policy stance. Apart from Powell's tone, markets will focus on the extent to which the new projections – the dot plot – will show that FOMC members find fewer rate hikes to be appropriate. We expect the dot plot to migrate much lower, but still with one rate hike later this year. QT details could be announced at the March meeting. We expect QT tapering in Q3 and QT to end in Q4.

Patience

The Fed is likely to stick to its "patience" stance at the March FOMC meeting, with "patience" meaning that rates will remain on hold until it becomes clear whether the economic outlook has worsened as much as the markets seem to believe or whether the outlook will remain relatively bright after the fog clears, as the majority of FOMC members still seem to believe.

Dot plot to migrate lower

Based on recent speeches, we believe that at least half of the dots will have migrated lower, reflecting FOMC members' reduced inclination to hike rates, with the median down to one hike this year (from two in December) and another hike in 2020 (unchanged from December).

QT details

Market sentiment has brightened and the FOMC may decide to keep the announcement about the details of the end of quantitative tightening (QT) for a rainy day, but some details could also be announced as early as next week. Our baseline continues to be a QT tapering starting in Q3 and QT ending in Q4, with excess reserves around USD 1,000bn. It will be market-negative if the Fed announces that excess reserves will continue to drop after the end of QT.

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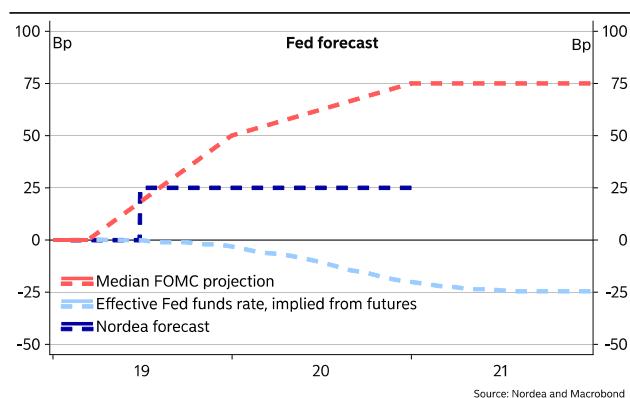
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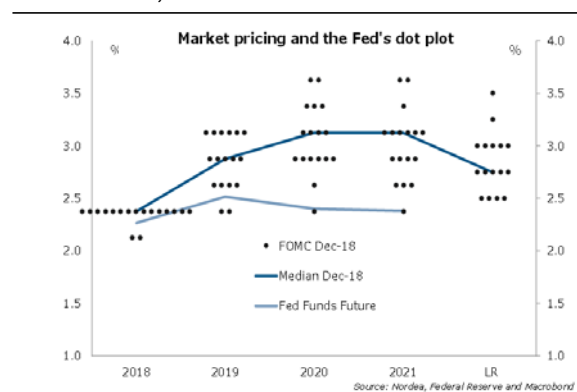
Relevant links

[Fed Watch: The end of QT](#)
[Fed Watch: When will the Fed stop?](#)
[Macro theme: Balance sheet relief](#)
[Macro theme: Recession roadmap](#)

FED FORECAST



THE DOT PLOT, %

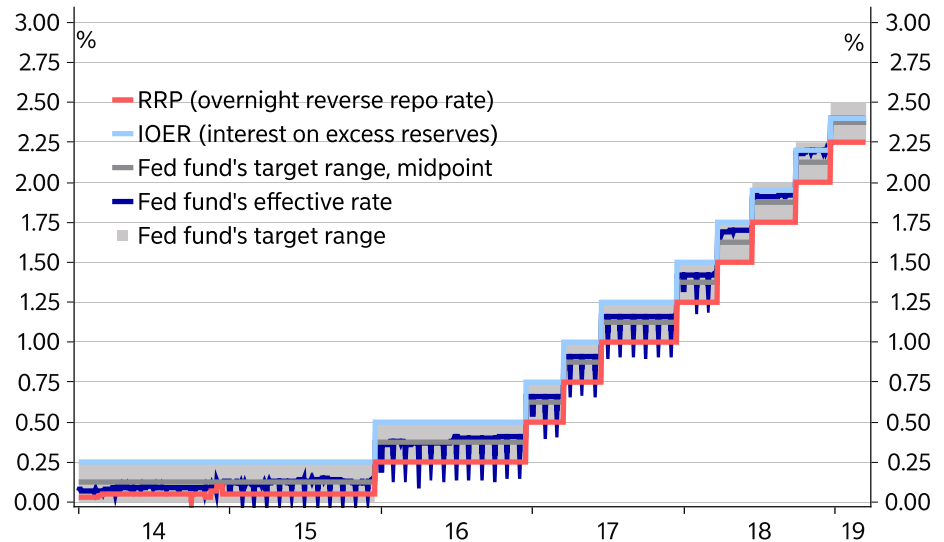


March preview: Substantial "dot migration"

Rates should be kept unchanged at the March meeting, with the interest on excess reserves (IOER) at 2.4% – close to the midpoint of the Fed Funds corridor. The focus will be on Powell's tone, the dot plot and any announcement of details regarding the end of QT.

Unchanged rates in March

FED'S RATES



Source: Nordea and Macrobond

Unchanged stance

Patience

There are no obvious reasons for the Fed to change its stance at the March meeting. "Patience" has been repeated by a number of FOMC members, which seems suitable for a wait-and-see approach. Key figures have been mixed and plenty of risks remain.

New projections will give a hint about the proportion of FOMC members who still believe in the December baseline of a decent economic outlook and who intend to hike rates when the fog clears, and the proportion of FOMC members who have started to agree with the markets that the economic outlook has worsened significantly.

The minutes of the January FOMC meeting showed that not many FOMC members had changed their view on the economy at that time, but went with "patience" because of market concerns, resulting in tighter financial conditions. That might very well still be the case.

Substantial "dot migration" to a lower level:

- 1 rate hike in 2019 (from 2 in December)
- 1 rate hike in 2020 (unchanged)
- Unchanged 2021 and LR

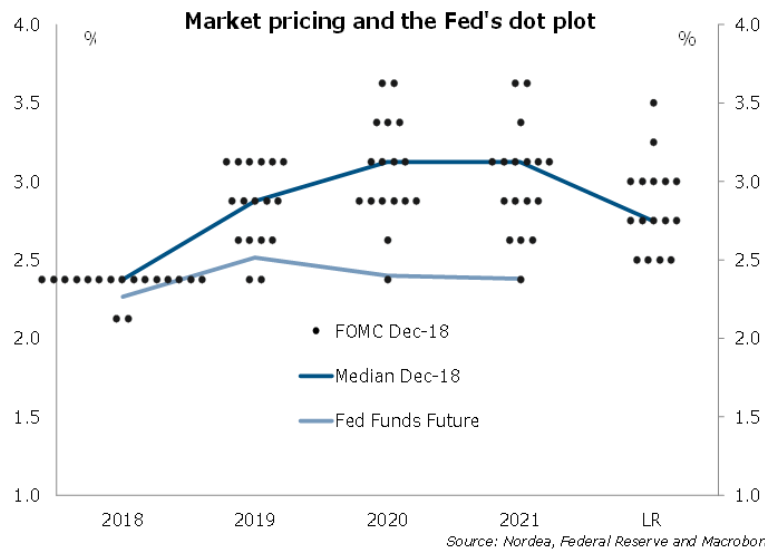
"Dot migration"

Still, based on speeches from FOMC members during the last three months, we believe that at least half of Fed's dot plot will migrate lower, ie individual FOMC members are inclined to vote for fewer or no rate hikes, with the median down to one hike in 2019. Few FOMC members have said anything about 2020 and beyond, but we believe the whole dot plot will shift down in parallel with 2019, implying a median of one more hike in 2020 and no hike in 2021 or the long run.

Governor Brainard, for instance, spoke in early December of "gradual rate hikes" as being "appropriate in the near term", but changed her tone three months later, saying that the "economy might warrant a softening of the Fed's policy path" and that "prudence counsels a period of watchful waiting". Chicago Fed President Evans was guiding for three rate hikes in 2019 in early January, while he recommended a few days later that it would be "a good point for sort of pausing" rate hikes. Cleveland Fed President Mester said in early January that, "one or two hikes is about where we're seeing the economy now" but adjusted her tone in February to "a rate increase may be needed later this year".

THE DOT PLOT, %

Huge discrepancy between the Fed and the markets



QT details

A passive and slower form of balance sheet policy tightening to continue after QT ends?

QT will end later this year. However, it has still not been decided whether excess reserves will continue to fall thereafter. We believe excess reserves are important to financial conditions in general and would view it as a market-negative in the medium term if the Fed were to announce that the balance sheet will be kept unchanged after the end of QT, allowing for a gradual and passive draining of excess reserves in the years to come.

In the near term, markets are probably much more focused on the timing of the end of QT: "the sooner, the better" and "the more abrupt, the better". As a baseline, we believe QT will be reduced – or tapered – in Q3 and will end in Q4, but little has been said from the Fed.

BY END-2019, QE2 & QE3 WILL HAVE BEEN UNDONE, QE1 MIGHT BE THE NEW NORMAL

QT to be tapered in Q3, end in Q4



Read more about our view on the Fed's balance sheet policies and the important choices ahead in [Macro theme: Balance sheet relief](#).

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