Economic and Financial Monthly (Mar, 2018)

Summary

The Fed raised the Fed funds rate by 0.25 and maintained its forward guidance of 3 rate hikes for 2018; The ECB removed its easing bias, but interest rate adjustments will not take place in the near future; China's economic momentum remains robust, while the impact of trade disputes with the U.S. should be contained; The Hong Kong dollar weakened to lowest point of its trading band, which would push up interest rates eventually.

■ U.S.: Rate hike guidance remained unchanged at three times

In March, the Fed raised interest rates for the first time in 2018 by 25 basis points to 1.5%-1.75%, while leaving its guidance of three rate hikes for the year unchanged. The unemployment rate has remained at 4.1% for six consecutive months, supporting gradual rate hikes. According to the FOMC's minutes, tax cuts would boost growth, but trade disputes would create uncertainties. Therefore, three rate hikes for the year should be a prudent base-case scenario.

Europe: Removing easing bias does not mean tightening

The ECB removed its easing bias by leaving out the sentence of increasing asset purchases if necessary. In fact, as the ECB has already halved it QE program, this change was largely symbolic. While the ECB could terminate bond purchases by the end of the year, interest rate adjustments will not take place until the second quarter of 2019, at the earliest. Therefore, one should not read too much into the change in wording, as there remain substantial differences between the ECB and the Fed in terms of their stance of monetary policy.

China: Trade disputes to have limited impact in the short run

China's economy was off to a solid start in 2018, with industrial production strengthening, fixed-asset investment rebounding, retail sales remaining steady, and international trade picking up pace. The goal of 6.5% growth for 2018 should be achieved without too much difficulty. When it comes to trade, China and the U.S. are very interdependent. To China, the U.S. is the largest export market. To the U.S., China provides the largest bilateral surplus in services trade and is a major market for many industries. As a result, neither country will be able to gain an advantage from a series of measures and countermeasures. Only by coming to the negotiating table can they reach a solution to trade disputes.

Hong Kong: Weak Hong Kong dollar puts upward pressure on interest rates

As Hong Kong interest rates remain substantially below U.S. dollar interest rates, the Hong Kong dollar has weakened since rate hikes in the U.S. accelerated in 2017. As the Hong Kong dollar touched its lower trading band, the HKMA has stepped in to purchase Hong Kong dollars to defend the peg, thereby reducing the aggregate balance of the banking system. While it is uncertain when Hong Kong dollar and U.S. dollar interest rates will converge, Hong Kong interest rates may inevitably have to rise. As a result, asset prices will also be pressured

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