

US - SEPTEMBER FED MEETING PREVIEW

RATE CUT ON THE CARDS, BUT COMMUNICATION TO BE MORE DIFFICULT

Summary

- The Federal Reserve (Fed) is very likely to cut rates again on 18 September, a follow up to its 25-basis point (bp) rate cut at its last meeting in July.
- The explanation is likely to again be the need to take “insurance” against growing downside risks to the outlook, including from President Trump’s erratic trade policy as well as weaker foreign growth.
- Fed Chairman Powell is unlikely to pre-commit to a third rate cut at this stage, even though we still think one is on the cards. The committee’s ‘dot plot’ could also only signal that two rate cuts are enough for now... But the dot plot is a red herring for the direction of rates and we should ignore it.
- Powell’s communication regarding the future path of rates could be made more difficult by the recent strengthening in inflation (especially in CPI data), signs of appeasement on the US-China trade front, as well as data at home reinforcing the ongoing resilience of the US consumer.
- But we think Powell will continue to underscore that global growth is still a glass half empty rather than full; he will also likely hint indirectly that a potential truce with China masks still sizeable underlying uncertainty, worth addressing with a further rate cut.
- Once again, Powell will likely push back against Trump’s meddling in the Fed’s monetary policy, as Powell tries to maintain some semblance of independence. All the same, we think Trump’s pressure has some indirect influence on the Fed’s actions. It is a further reason to believe that the Fed will go ahead with a third rate cut – which we expect on 30 October – especially if global growth data stays wobbly.
- From a fundamental perspective, we continue to think the Fed is in a ‘debt dominance’ regime, where high private debt will constrain the Fed’s actions and force it to remain dovish throughout the medium term.

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Rate cut very likely but greater need for an explanation

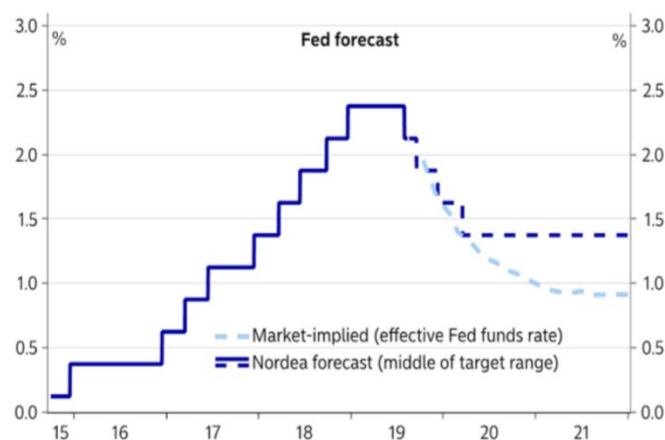
The Fed is very likely to cut rates again by 25bps on 18 September, which will mark the second rate cut of this “easing cycle”, that Powell has compared to the pre-emptive easing of the 1990s under Greenspan. At the July meeting Powell referred to the first rate cut as mere “mid cycle adjustment”.

In September 1998 in particular, then Chairman Greenspan cut rates by 25bps at three successive meetings, against a similar backdrop of wobbly global growth. This time however, US trade policy is part of the “culprit” behind the global slowdown. A key difference with 1998 is that then a large hedge fund had failed, creating large liquidity problems in markets, an issue we are not faced with now.

Powell is once again likely to justify this monetary easing as “insurance” against downside risks to US growth. Those risks mostly stem from the uncertain US trade policy outlook (and recent tariffs slapped on China), the weak global growth picture, including disappointments in Europe and China and the persistence of Brexit risk. The minutes of the last meeting also showed that the Fed was even following political developments in Hong Kong. Powell is once again likely to underscore that the Fed does not see a recession in the pipeline, and therefore that these are not “recession rate cuts” like in 2007. It is also a reason why the Fed is not cutting more forcefully, like 50 bps per meeting.

During the press conference, Powell will face a more difficult task in explaining the justification for a second rate cut given the need is less obvious. Indeed, there are signs of a potential trade truce with China, especially as the two sides are set to meet in October, which could undermine at the margin Powell’s main argument. But we think Powell is likely to hint that he does not really ‘trust’ the solidity of any bilateral truce. Such cautiousness was already on display at the July Fed meeting, and subsequently proved correct after Trump did an impressive volte face and slapped new tariffs on China in August.

Further complexifying the picture is that inflation pressures are getting firmer. This is particularly the case with CPI inflation data, which showed core CPI rising to 2.4% year-over-year (y-o-y) in August. That said, PCE not CPI is the Fed’s main target. Powell could also highlight that market based pricing of future inflation is still measly. Third and more fundamentally, the Fed must always prioritise medium-term growth concerns over short-term inflation pressures. Right now, the Fed is prioritising the weak global growth picture over anything else.



Finally, the Fed is also cutting rates for 'recalibration' reasons, especially as the Fed is concerned about having its short-term rates above long-term market rates – an inverted yield curve being an ominous signal for a coming recession among economist circles. The Fed is actively looking to correct the yield curve, even though it does not publicly say so. It is true that long term yields have backed up a bit in recent days does reduce the pressure at the margin, but the pressure from the yield curve remains.

On a more technical note, there have been ructions in the Treasury repo space in recent days (the rate on overnight repurchase agreements soared above 10% on 17 September, as we were writing this note, although the New York Fed came forcefully with new liquidity operations). Powell is likely to be questioned about these events, and the New York Fed's role is particularly going to be in the limelight. Very likely, Powell's line of defence will be that it is only a short-term technicality and that the New York Fed took the right measure.

That being said, this spike in collateral repo rates comes as the Federal Reserve is expected to communicate more precisely about the level of bank reserves it targets in the medium term. These bank reserves had been shrinking rapidly as the Fed reduced its balance sheet this year (until August), and such diminution had already raised concerns around a potential lack of market liquidity.

We think these issues on the repo market underscore the need for higher than expected bank reserves (at the Fed), which could ultimately lead to some new asset purchases being announced soon to replenish this segment. A decision is likely to happen as soon as Q4 this year or Q1 of next year. But the recent spike in collateral rates raises a risk that these decisions about asset purchases, which some market participants may translate as new "quantitative easing" may come earlier than planned. A dovish surprise would be an announcement about restarting Treasury purchases as soon as this meeting.

Bottom line is that we do not think Powell will likely be explicit in pre-committing that a third rate cut is in the pipeline, but after all, he was not explicit either at the last meeting. We would therefore advise avoiding extrapolation from what Powell says on 17 September. As an aside, we would caution against reading too much into the 'dot plot', which we think will show that most Fed members expect to keep the 'insurance easing' to two cuts at this stage.

The dot plot was a red herring at the June meeting, when it showed that most members expected no cut this year, even though the Fed is now about to cut rates a second time!

Bottom line – Fed to cut rates again. Risks to 2020's picture to the downside

As said above, we think any hawkishness may prove short lived, as the Fed is likely to remain focused on the growth risks, which are unlikely to diminish in coming weeks. Meanwhile, Trump's pressure is unlikely to abate – Trump seems particularly envious of the massive easing recently announced by the European Central Bank – and we think any truce with China is unlikely to be game changing (most tariffs are likely to stay anyway).

Bottom line is we still expect the Fed to continue to follow the Greenspan playbook and cut rates a third time as in 1998. In other words, we continue to expect a third cut at the 30 October meeting.

Regarding 2020, our central scenario sees Fed rates unchanged, but there are growing risks that the Fed may continue to cut slowly as the 'path of least resistance' even if at this stage we do not foresee an economic recession. But we think Trump's pressure could intensify in the context of the electoral season. Furthermore, one will have to watch how Trump influences Fed policy via his nominations to the Fed Board (two are still pending Senate approval).

FED MEETING CHEAT SHEET

	Dovish surprise	Central scenario	Hawkish surprise
Rate decision	- 50 bps rate cut	- 25bps rate cut (new FFTR range of 1.75-2.0%) - Also 25bps rate cut to IOER (to 1.85%)	- No rate cut
Dot plot & economic projections	- Median 2019 dot showing three cuts - Longer run dot drops to 2.4%	- Median 2019 dot: two cuts (but circa 6-7 dots at three), 2020 median: one further cut - Longer run dot stays at 2.5%	- Fewer than five Fed members puts three rate cuts as their 2019 baseline - Core PCE inflation f' cast for 2020 raised to 2.0%
Statement	- Explicit mention the Fed is watching global developments "closely" - Mention of recent liquidity issues in collateral market	- 'Act as appropriate to sustain the expansion' stays - 'Uncertainties' about the outlook are high	- Bullish characterization of the US economy and recent data (i.e. keeps job gains have been "solid")
Press conference	- Powell pre-announces fresh programme of Treasury buying to replenish bank reserves at the Fed (i.e. liquidity issues)	- Most airtime spent discussing weak global growth - Some cautiousness about a potential US-China truce	- Explicit mention that Fed is done cutting for now - More emphasis on recent strong CPI inflation

GOLD STRATEGIES

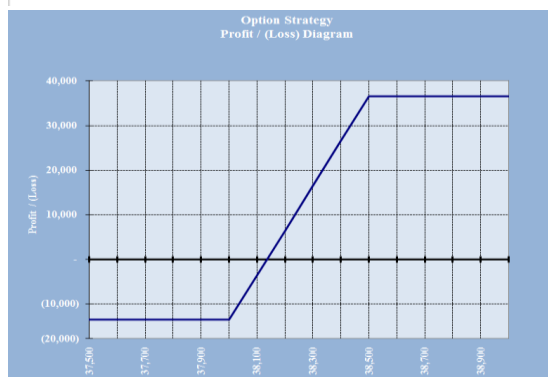
1. BULLISH VIEW

GOLD OPTION STRATEGY PAY-OFF				
RANGE	High 39000	Low 37500	Increment 100	Underlying 37819.00

INPUT TABLE					
Instrument	Initial Position	Strike Price	Current Price	Lot	Investments
Call Option 1	Buy	38,000.00	250.00	100	-25000
Call Option 2	Sell	38,500.00	115.00	100	11500
				Net Investment:	-13500

SCENARIO AT EXPIRY DATA TABLE			VIEW
Instrument	Call Option 1	Call Option 2	
Initial Position	Buy	Sell	BULLISH
Option Strike	38000	38500	
Units Traded	100	100	

Prices at Option Expiry	Cash Flow at CE Expiry	Cash Flow at CE Expiry	Total Cash Flow at Expiry	Position P/L at Expiry
37500	0	0	0	-13500
37600	0	0	0	-13500
37700	0	0	0	-13500
37800	0	0	0	-13500
37900	0	0	0	-13500
38000	0	0	0	-13500
38100	10000	0	10000	-3500
38200	20000	0	20000	6500
38300	30000	0	30000	16500
38400	40000	0	40000	26500
38500	50000	0	50000	36500
38600	60000	-10000	50000	36500
38700	70000	-20000	50000	36500
38800	80000	-30000	50000	36500
38900	90000	-40000	50000	36500
39000	100000	-50000	50000	36500



ACTION:

BUY GOLD 38000 CE @ 250

SELL GOLD 38500 CE @ 115.

ENTRY: 135.00 SL 0.00 TGT 320.00-450.00.

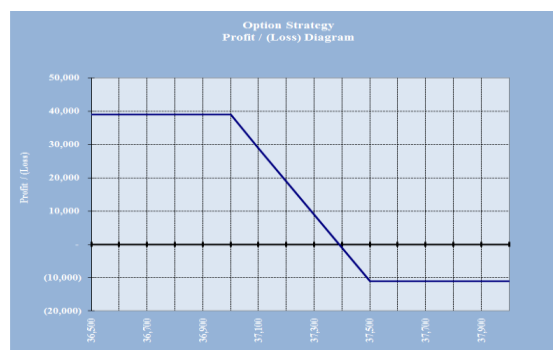
2. BEARISH VIEW

GOLD OPTION STRATEGY PAY-OFF				
RANGE	High	Low	Increment	Underlying 37780.00
		38000	36500	

INPUT TABLE					
Instrument	Initial Position	Strike Price	Current Price	Lot	Investments
Put Option 1	Buy	37,500.00	178.00	100	-17800
Put Option 2	Sell	37,000.00	68.00	100	6800
Net Investment:					-11000

SCENARIO AT EXPIRY DATA TABLE			VIEW
Instrument	Put Option 1	Put Option 2	
Initial Position	Buy	Sell	BEARISH
Option Strike	37500	37000	
Units Traded	100	100	

Prices at Option Expiry	Cash Flow at PE Expiry	Cash Flow at PE Expiry	Total Cash Flow at Expiry	Position P/L at Expiry
36500	100000	-50000	50000	39000
36600	90000	-40000	50000	39000
36700	80000	-30000	50000	39000
36800	70000	-20000	50000	39000
36900	60000	-10000	50000	39000
37000	50000	0	50000	39000
37100	40000	0	40000	29000
37200	30000	0	30000	19000
37300	20000	0	20000	9000
37400	10000	0	10000	-1000
37500	0	0	0	-11000
37600	0	0	0	-11000
37700	0	0	0	-11000
37800	0	0	0	-11000
37900	0	0	0	-11000
38000	0	0	0	-11000



ACTION:
BUY GOLD 37500 PE @ 178
SELL GOLD 37000 PE @ 68.
ENTRY: 110.00 SL 0.00 TGT 260.00-420.00.

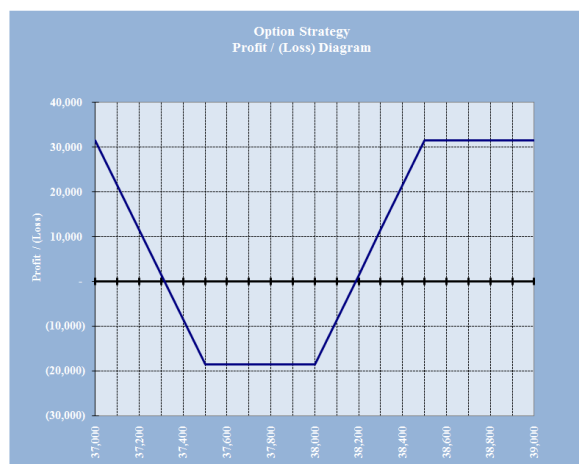
3. NEUTRAL WITH BULLISH

GOLD OPTION STRATEGY PAY-OFF				
RANGE	High	Low	Increment	Underlying 37770.00
	39000	37000	100	

INPUT TABLE					
Instrument	Initial Position	Strike Price	Current Price	Lot	Investments
Call Option 1	Buy	38,000.00	250.00	100	-25000
Call Option 2	Sell	38,500.00	115.00	100	11500
Put Option 1	Buy	37,500.00	50.00	100	-5000
Net Investment:					-18500

SCENARIO AT EXPIRY DATA TABLE				VIEW
Instrument	Call Option 1	Call Option 2	Put Option 1	
Initial Position	Buy	Sell	Buy	BULLISH
Option Strike	38000	38500	37500	
Units Traded	100	100	100	

Prices at Option Expiry	Cash Flow at CE Expiry	Cash Flow at CE Expiry	Cash Flow at PE Expiry	Total Cash Flow at Expiry	Position P/L at Expiry
37000	0	0	50000	50000	31500
37100	0	0	40000	40000	21500
37200	0	0	30000	30000	11500
37300	0	0	20000	20000	1500
37400	0	0	10000	10000	-8500
37500	0	0	0	0	-18500
37600	0	0	0	0	-18500
37700	0	0	0	0	-18500
37800	0	0	0	0	-18500
37900	0	0	0	0	-18500
38000	0	0	0	0	-18500
38100	10000	0	0	10000	-8500
38200	20000	0	0	20000	1500
38300	30000	0	0	30000	11500
38400	40000	0	0	40000	21500
38500	50000	0	0	50000	31500
38600	60000	-10000	0	50000	31500



ACTION:
BUY GOLD 38000 CE @ 250
SELL GOLD 38500 CE @ 115
BUY GOLD 37000 PE @ 50.
ENTRY: 185 SL 0.00 TGT 420-500.



FOMC MEETING



GOLD PRICE MOVEMENT SINCE 2010													
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	Growth
2010	16200	16789	16295	17125	18385	18852	17770	19134	19035	19807	20538	20728	4042.00
	-2.91	3.64	-2.94	5.09	7.36	2.54	-5.74	7.68	-0.52	4.06	3.69	0.93	24.22
2011	19922	20923	20693	22820	22426	21904	23166	27184	25989	27343	29061	27329	6601.00
	-3.89	5.02	-1.10	10.28	-1.73	-2.33	5.76	17.34	-4.40	5.21	6.28	-5.96	31.85
2012	28078	27952	28518	29183	29148	29665	29749	31206	31535	31105	31076	30859	3530.00
	2.74	-0.45	2.02	2.33	-0.12	1.77	0.28	4.90	1.05	-1.36	-0.09	-0.70	12.92
2013	29871	29570	29394	26905	26874	25669	28207	35074	29874	29793	29234	28364	-2495.00
	-3.20	-1.01	-0.60	-8.47	-0.12	-4.48	9.89	24.35	-14.83	-0.27	-1.88	-2.98	-8.09
2014	29462	30090	28536	28887	26863	27776	27818	27996	26313	25881	25835	26703	-1661.00
	3.87	2.13	-5.16	1.23	-7.01	3.40	0.15	0.64	-6.01	-1.64	-0.18	3.36	-5.86
2015	27895	26477	26204	26716	26860	26471	24813	26682	25856	26499	25069	24931	-1772.00
	4.46	-5.08	-1.03	1.95	0.54	-1.45	-6.26	7.53	-3.10	2.49	-5.40	-0.55	-6.64
2016	26638	29513	28549	30266	28627	31199	31549	30724	30742	29950	28385	27445	2514.00
	6.85	10.79	-3.27	6.01	-5.42	8.98	1.12	-2.61	0.06	-2.58	-5.23	-3.31	10.08
2017	28942	29566	28463	28873	28843	28439	28557	29745	29557	29153	29012	29000	1555.00
	5.45	2.16	-3.73	1.44	-0.10	-1.40	0.41	4.16	-0.63	-1.37	-0.48	-0.04	5.67
2018	30117	30379	30408	31036	30831	30432	29653	30129	30481	31748	30240	31391	2391.00
	3.85	0.87	0.10	2.07	-0.66	-1.29	-2.56	1.61	1.17	4.16	-4.75	3.81	8.24
2019	33096	33286	31998	31756	32266	34206	35420	38805					7414.00
	5.43	0.57	-3.87	-0.76	1.61	6.01	3.55	9.56					23.62
Average	2.27	1.86	-1.96	2.12	-0.56	1.18	0.66	7.51	-3.02	0.97	-0.89	-0.61	Average

GOLD\$ PRICE MOVEMENT SINCE 2010													
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	Change
2010	1080.80	1117.40	1112.95	1179.05	1214.20	1241.35	1181.05	1247.29	1308.10	1359.20	1386.70	1421.00	324.65
	-1.42	3.39	-0.40	5.94	2.98	2.24	-4.86	5.61	4.88	3.91	2.02	2.47	29.61
2011	1333.00	1412.10	1430.39	1562.90	1534.80	1499.90	1626.20	1823.70	1623.60	1713.80	1748.30	1565.30	144.30
	-6.19	5.93	1.30	9.26	-1.80	-2.27	8.42	12.14	-10.97	5.56	2.01	-10.47	10.15
2012	1737.00	1695.10	1668.13	1663.70	1559.80	1597.43	1613.70	1690.70	1771.90	1718.36	1714.70	1675.40	110.10
	10.97	-2.41	-1.59	-0.27	-6.25	2.41	1.02	4.77	4.80	-3.02	-0.21	-2.29	7.03
2013	1663.50	1578.20	1594.30	1474.75	1387.81	1234.80	1322.40	1395.20	1327.50	1323.30	1251.40	1204.90	-470.50
	-0.71	-5.13	1.02	-7.50	-5.90	-11.03	7.09	5.51	-4.85	-0.32	-5.43	-3.72	-28.08
2014	1244.30	1327.60	1284.00	1291.10	1250.50	1326.75	1281.70	1287.01	1208.50	1172.59	1167.23	1183.96	-20.94
	3.27	6.69	-3.28	0.55	-3.14	6.10	-3.40	0.41	-6.10	-2.97	-0.46	1.43	-1.74
2015	1283.18	1212.86	1183.30	1183.70	1189.90	1172.75	1096.00	1134.35	1114.55	1141.50	1065.80	1072.80	-111.16
	8.38	-5.48	-2.44	0.03	0.52	-1.44	-6.54	3.50	-1.75	2.42	-6.63	0.66	-9.39
2016	1117.69	1238.00	1232.15	1292.77	1214.95	1321.41	1350.57	1308.90	1316.10	1276.75	1172.60	1150.90	78.10
	4.18	10.76	-0.47	4.92	-6.02	8.76	2.21	-3.09	0.55	-2.99	-8.16	-1.85	7.28
2017	1210.00	1247.50	1248.78	1267.91	1268.55	1241.33	1268.95	1320.65	1279.72	1270.65	1274.50	1302.54	151.64
	5.14	3.10	0.10	1.53	0.05	-2.15	2.23	4.07	-3.10	-0.71	0.30	2.20	13.18
2018	1344.80	1318.00	1325.03	1315.50	1297.90	1252.40	1223.70	1201.50	1190.40	1215.00	1222.10	1282.20	-20.34
	3.24	-1.99	0.53	-0.72	-1.34	-3.51	-2.29	-1.81	-0.92	2.07	0.58	4.92	-1.56
2019	1320.60	1313.10	1291.90	1285.70	1305.80	1395.15	1431.20	1535.00					252.80
	2.99	-0.57	-1.61	-0.48	1.56	6.84	2.58	7.25					19.72
Average	2.99	1.43	-0.68	1.33	-1.93	0.60	0.65	3.84	-1.94	0.44	-1.77	-0.74	Average


USDINR PRICE MOVEMENT SINCE 2011

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	Growth
2011	46.14	45.50	44.75	44.47	45.24	44.88	44.43	46.10	49.16	48.98	52.54	53.49	8.58
	2.74	-1.37	-1.65	-0.63	1.74	-0.81	-0.99	3.76	6.63	-0.37	7.28	1.80	19.11
2012	49.75	49.37	51.22	53.03	56.42	56.11	55.84	55.79	53.05	54.08	54.61	55.15	1.66
	-7.00	-0.76	3.76	3.53	6.39	-0.55	-0.49	-0.09	-4.90	1.93	0.98	0.99	3.11
2013	53.39	54.74	54.67	53.95	56.79	59.75	61.06	66.73	63.21	61.81	62.91	62.16	7.01
	-3.19	2.51	-0.11	-1.33	5.27	5.20	2.19	9.29	-5.27	-2.22	1.78	-1.20	12.70
2014	63.08	62.22	60.17	60.56	59.32	60.57	60.85	60.95	62.10	61.64	62.39	63.47	1.32
	1.49	-1.37	-3.29	0.65	-2.05	2.12	0.47	0.16	1.89	-0.74	1.21	1.74	2.12
2015	62.24	62.22	62.83	63.81	64.20	64.01	64.49	66.84	65.90	65.61	66.98	66.39	2.92
	-1.95	-0.03	0.98	1.55	0.62	-0.30	0.75	3.64	-1.40	-0.44	2.08	-0.87	4.60
2016	68.10	68.77	66.51	66.67	67.60	67.77	67.29	67.27	66.88	67.08	68.56	68.10	1.71
	2.58	0.98	-3.29	0.24	1.40	0.26	-0.71	-0.03	-0.59	0.30	2.22	-0.67	2.58
2017	68.06	66.94	65.08	64.53	64.88	64.82	64.64	64.08	63.89	64.98	64.65	64.06	-4.04
	-0.06	-1.65	-2.78	-0.85	0.54	-0.09	-0.28	-0.87	-0.30	1.71	-0.51	-0.91	-5.94
2018	63.79	65.32	65.36	66.90	67.63	68.73	68.79	71.19	72.76	74.20	69.85	69.94	5.88
	-0.43	2.39	0.07	2.35	1.09	1.63	0.09	3.49	2.21	1.98	-5.86	0.13	9.18
2019	71.29	71.10	69.51	69.85	69.90	69.30	68.98	71.62					1.68
	1.93	-0.27	-2.24	0.49	0.07	-0.86	-0.46	3.83					2.40
Average	-0.43	0.05	-0.95	0.67	1.67	0.73	0.06	2.58	-0.22	0.27	1.15	0.13	Average



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