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## Expecting a more dovish Yellen

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**Maritza Cabezas**

Senior Economist

Tel: +31 20 343 5618

maritza.cabezas@nl.abnamro.com

**Arjen van Dijkhuizen**

Senior Economist

Tel: +31 20 628 8052

arjen.van.dijkhuizen@nl.abnamro.com

- **Chair Yellen will give testimony to Congress on Wednesday and Thursday**
- **We expect a dovish tone given the global headwinds...**
- **...but she may well leave the door open for further gradual rate hikes,**
- **...conditioned to economic data and financial conditions**
- **We do not expect the Fed to hike before June**
- **China's FX reserves dropped by another USD 100bn in January, but less than expected**

### **Chair Yellen will give testimony to Congress on Wednesday and Thursday**

Since the Fed hiked rates in December, global headwinds are putting into question further rate hikes this year. In December, the Fed had penciled in four rate hikes. Special focus will be placed on Chair Yellen's intervention to see if there are any signs that her tone has changed with respect to the path of rate hikes. We still expect three rate hikes with the next one in June, but the risks are skewed towards a longer period on hold.

### **Global conditions deteriorated since previous testimony...**

In her last testimony in July 2015, Chair Yellen was quite positive about the progress made by the US labour market and the inflation outlook, given stable market-based inflation expectations. She was optimistic that the US could snap back quickly from the impact of the global headwinds, including the effects of a strong US dollar and China's challenges in dealing with its high debt. However, the international picture has become more cloudy.

### **...while the US economy has weakened**

Foreign developments have increased the risks of a slowdown in the US. The slide in oil prices and its duration has been more extended than expected, increasing downward risks for the global economy. Perhaps Chair Yellen will continue to emphasise their temporary nature, but the impact on the US cannot go unmentioned. Financial conditions have tightened as a result of the slide in the equity market and a stronger US dollar. Meanwhile, market-based inflation expectations have fallen since then. The labour market remains the bright spot and wage growth has been gradually increasing.

### **We expect a dovish testimony, but options open for further hikes**

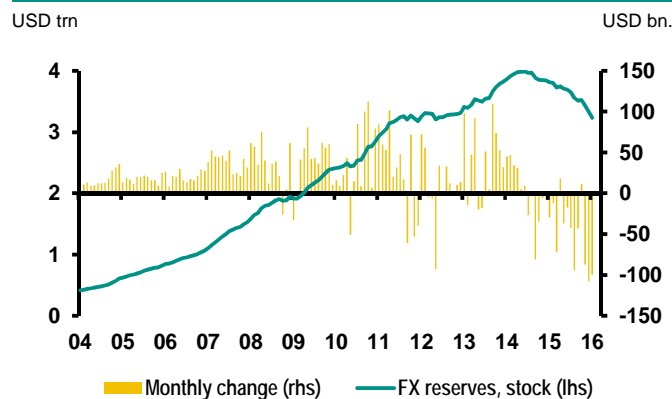
We expect Chair Yellen to leave the FOMC's options open for March, but to signal that March has become much less likely given her concerns regarding global developments as

other FOMC members have communicated in the past few days. Indeed Vice Chairman Fischer mentioned that they would be watching if global developments could lead to persistent tightening of financial conditions and lower growth and inflation.

### China's FX reserves fell by another USD 100 bn in January, less than expected

Last Sunday, China's foreign reserves were reported at USD 3231 billion in January 2016, down by another USD 99.5 bn. China's stock of FX reserves is now at the lowest level since May 2012 and has lost almost 20% from the peak level of USD 3.99 trillion reached in June 2014. The average decline in the past three months of USD 98 billion compares to an average decline of USD 43 billion in 2015. That said, the drop in January was a bit below the market consensus expectation of USD 120 billion. Should China's FX reserves continue to fall in a similar pace as in the past three months, doubts about the sustainability of the exchange rate regime would intensify. Hence, this issue deserves close monitoring.

#### China's FX reserves further down in January



Source: Thomson Reuters Datastream

### Chinese authorities should still be able to handle the situation

However, we are still of the view that the Chinese authorities will be able to handle the situation, for several reasons. First, a substantial portion of the capital outflows relates to companies repaying foreign debt and/or starting to hedge FX exposures. These are not really 'disruptive' capital outflows in the sense that they mitigate FX-related risks. Second, the drop in FX reserves partly reflects FX interventions by the PBoC, which together with other measures (e.g. the recent lowering of the USDCNY fixing) has helped to stabilise the bilateral USD/CNY rate. This should help mitigate capital outflows going forward. Third, China still has a huge stock of FX reserves, covering more than three times its full external debt, five times its short-term external debt and around 17 months of imports. These coverage ratios are still very high by EM standards (also see our *Asia Outlook* 'Resilience despite China hiccups, but risks remain' published on 8 February 2016). Finally, China has a huge surplus on the current account (reaching a seven-year high of around USD 300 bn in 2015), meaning that – ceteris paribus - FX reserves should stabilise if net capital outflows fall back to around USD 25 bn per month.

Day	Date	Time	Country	Key Economic Indicators and Events	Period	Latest outcome	Consensus	ABN AMRO
Sunday	07/02/2016		CN	Foreign Reserves - USD bn	Jan	3330.0	3212.5	
Monday	08/02/2016	08:00:00	DE	Industrial production - % mom	Dec	-0.3	0.4	<b>0.0</b>
Monday	08/02/2016	13:00:00	IN	GDP - % yoy	4Q	7.4	7.1	
Tuesday	09/02/2016	12:00:00	US	NFIB small business optimisme - index	Jan	95.2	94.5	<b>94.0</b>
Tuesday	09/02/2016	16:00:00	US	US Job Openings by Industry	Dec	5431		
Wednesday	10/02/2016	15-Feb	CN	M2 money growth - % yoy	Jan	13.3	13.5	
Wednesday	10/02/2016	15-Feb	CN	Aggregate financing - CNY bn	Jan	1820.0	2300.0	
Wednesday	10/02/2016	15-Feb	CN	New loans - CNY bn	Jan	597.8	1865.0	
Wednesday	10/02/2016	23:00:00	US	Fed's Yellen to appear before house financial services committee				
Thursday	11/02/2016	06:30:00	NL	CPI - % yoy	Jan	0.7		<b>1.0</b>
Thursday	11/02/2016	06:30:00	NL	GDP - % qoq	4Q P	0.1		<b>0.4</b>
Thursday	11/02/2016		SE	Policyrate - %	Feb 11	-0.4		<b>-0.4</b>
Thursday	11/02/2016	16:00:00	US	Fed's Yellen to appear before senate banking committee				
Friday	12/02/2016	03:30:00	IN	CPI - % yoy	Jan	5.6		
Friday	12/02/2016	08:00:00	DE	CPI - % yoy	Jan F	0.5	0.5	
Friday	12/02/2016	08:00:00	DE	GDP - % qoq	4Q P	0.3	0.3	<b>0.3</b>
Friday	12/02/2016	11:00:00	EC	Industrial production - % mom	Dec	-0.7	0.3	
Friday	12/02/2016	11:00:00	EC	GDP - % qoq	4Q A	0.3	0.3	<b>0.2</b>
Friday	12/02/2016	14:30:00	US	Retail sales - % mom	Jan	-0.1	0.1	<b>0.1</b>
Friday	12/02/2016	16:00:00	US	Univ. of Michigan cons. confidence - index	Feb P	92.0	93.0	<b>92.0</b>
Friday	12/02/2016	16:00:00	US	Business inventories - % mom	Dec	-0.2	0.10	

Source: Bloomberg, Reuters, ABN AMRO Group Economics (we provide own forecasts only for selected key variables and events)

Find out more about Group Economics at: <https://insights.abnamro.nl/en/>

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ABN AMRO Bank  
Gustav Mahlerlaan 10 (visiting address)  
P.O. Box 283  
1000 EA Amsterdam  
The Netherlands

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