15 June 2023

ECONOMIC REVIEW | June 2023 US FOMC Meeting

The First Pause by Fed After Cumulative 500bps Hikes Since Mar-22

- *No change to FFR as widely expected. Similar to overwhelming market expectations for no hike, the Fed's FOMC finally decided to pause and keep Fed funds rate at the target range of 5.00-5.25%.*
- *FOMC upgraded growth and inflation outlook. FOMC upgraded US growth outlook but foresees inflation will take somewhat longer to reach 2% target. US GDP growth for this year was revised upward to +1% (Mar-23 projection: +0.4%), with higher core PCE inflation at +3.9% (Mar-23 projection: +3.6%).*
- *Fed to keep FFR at current high levels but rooms to hike. Despite the upward revision to the Fed's projections on the fed funds rate, we foresee fed funds rate will be kept at current high levels this year. We opine there is less need for more (aggressive) hikes as the current rate already exceeded core PCE inflation.*

No change to FFR as widely expected. Similar to overwhelming market expectations for no hike, the Fed's FOMC finally decided to pause and keep fed funds rate at the target range of 5.00-5.25%. The FOMC stated in its statement that the central bank will keep its policy focus towards managing inflation risk which has been its major concern that could destabilize the US economy. Nevertheless, the expected 'skip' in Jun-23 from further rate adjustment was backed by earlier signal by some of the Fed's policymakers to wait for more data before deciding on the future policy direction. Despite keeping its Fed funds rate unchanged, the Fed indicated that it will continue to reduce holdings of securities i.e. reduce its balance sheet as part of its policy tightening.

FOMC upgraded growth and inflation outlook. FOMC upgraded US growth outlook but foresees inflation will take somewhat longer to reach 2% target. The US economy is expected to grow at +1% this year, an upward revision from +0.4% previously. The FOMC also revised upward its forecast for core PCE inflation for 2023 to +3.9% (Mar-23 projection: +3.6%). Due to this, the FOMC forecasted the Fed funds rate will be raised to higher level of +5.6% (Mar-23: +5.1%) to ensure interest rates remained at restrictive level. According to the Fed Chair, the upward revision indicates a higher terminal rate as most FOMC members think interest rates will need to go higher until there is clear and convincing downward trend in inflation.

Pause but not the end of tightening. As the rate outlook has been revised higher, Fed Chair highlighted that there was no discussion about possible rate cuts this year. The pause is not the end of its policy tightening as the he mentioned Fed wants to see US inflation go lower. He foresees upcoming meetings will remain 'lively' and take into account more up-to-date information, reiterating that the Fed keeps an open stance on further changes in the Fed funds rate (either more hikes or another pause) at future meetings.

Inflation remained the key concern. US headline CPI inflation has been on moderating trend from the recent peak in Jun-22, easing further to +4%yoy which was the slowest since Mar-21. Using the Fed's preferred measure, the Fed hopes to see a more significant decline in core PCE price inflation which thus far has been hovering around +4.5% for a few months. Nevertheless, with core CPI inflation easing to +5.3%yoy in May-23, we expect core PCE inflation will also ease further after it rose slightly to +4.7% in Apr-23. Chair Powell once again shared that inflation has been easing particularly due to slower rise in goods inflation on the back of better supply conditions, while price pressures continued to come from the increased demand and rising services charges including housing-related services charges. Chair Powell also repeated that the below-trend growth and eventual rebalancing of the job market are part of the formula to contain and push inflation lower.

Tight labour market keeps the economy resilient. The Fed still concluded that the labour market condition remained tight, and eventual cooling off due to the aggressive rate hikes will help to keep price pressures under control. In fact, the strength in the labour market remains the main factor contributing to rising wages and keeping the economy resilient in coping with the aggressive tightening. The latest data showed job creation was higher than expected in May-23 as nonfarm payrolls rose by +339K (Apr-23: +294K; consensus: +190K). Demand for labour remained strong as total job vacancies surprisingly jumped to 10.1m in Apr-23 after reaching 2-year low in the previous month (Mar-23: 9.7m). In contrast, there were early signs of cooling off as unemployment rate rose to 3.7%, the highest in 7 months. In addition, initial filings for jobless claims rose +261K, the highest since Oct-21 and trending higher in 3 weeks until 3 June 2023. Nevertheless, the Fed concluded the job market remained tight and the jobless rate was still at low levels.

Tighter credit standards can hit the economy. The FOMC also reiterated tightening of credit standards by banks would affect economic activities of both by households and businesses. However, Fed Chair indicated that it remains unclear how significant the impact has been particularly from the recent banking sector turmoil. He mentioned that tightening of credit conditions and the lagged effects of rate hikes are among areas which the Fed requires more time and data to assess the impacts on the broader US economy.

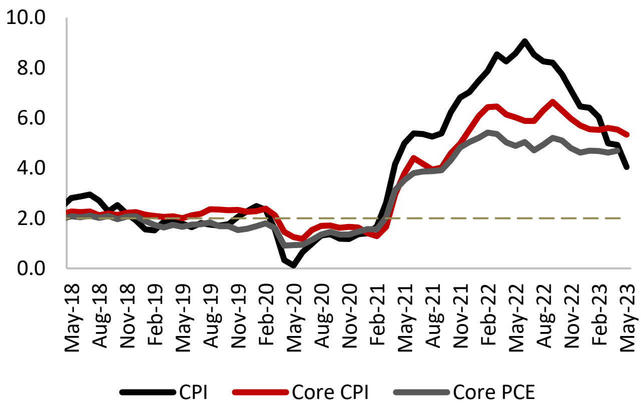
Fed to keep FFR at current high levels but rooms to hike. Despite the upward revision to the Fed's projections on the fed funds rate, we foresee Fed funds rate will be kept at current high levels this year. In other words, we opine there is less need for more (aggressive) hikes as the current rate already exceeded core PCE inflation for several months, with core PCE inflation remaining below +5% since Nov-22. At the same time, we opine that tightening of credit standards because of the banking turmoil will hurt US economic growth. Moreover, the continued tightening will also come from further reductions in the Fed's balance sheets. On the other hand, if inflation remains sticky and does not ease further, there is room for the Fed to hike interest rates given the still robust labour market and resilience in the US economy after cumulative +500bps hikes since Mar-22. This will be subject to incoming inflation data, whether the policy rate needs to be hiked for quicker disinflation progress.

Table 1: Central Bank Policy Rate by Selected Economies (%)

	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
Malaysia	2.50	2.75	2.75	2.75	2.75	2.75	2.75	3.00	3.00
Indonesia	4.75	5.25	5.50	5.75	5.75	5.75	5.75	5.75	5.75
Philippines	4.25	5.00	5.50	5.50	6.00	6.25	6.25	6.25	6.25
Thailand	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75	2.00
Vietnam	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
South Korea	3.00	3.25	3.25	3.50	3.50	3.50	3.50	3.50	3.50
India	5.90	5.90	6.25	6.25	6.50	6.50	6.50	6.50	6.50
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	2.25	3.00	3.50	3.50	4.00	4.25	4.25	4.25	4.25
Euro area	2.00	2.00	2.50	2.50	3.00	3.50	3.50	3.75	3.75
US	3.00-3.25	3.75-4.00	4.25-4.50	4.25-4.50	4.50-4.75	4.75-5.00	4.75-5.00	5.00-5.25	5.00-5.25

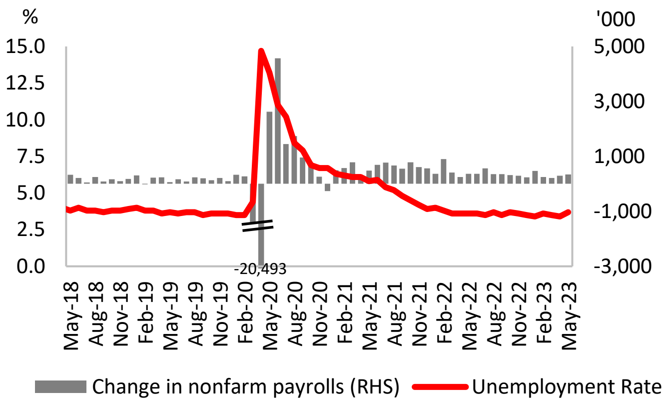
Source: Bloomberg; MIDFR

Chart 1: US CPI vs Core PCE Inflation (%)



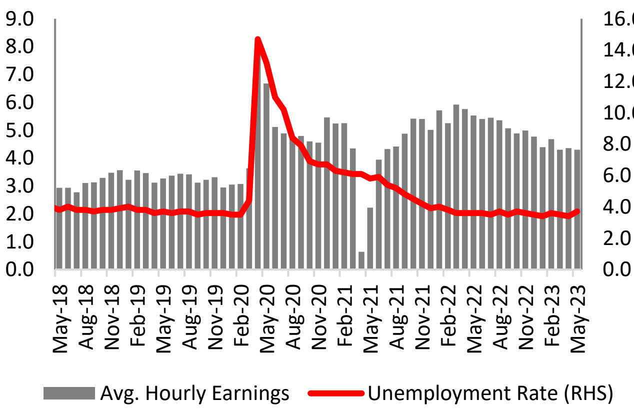
Source: Macrobond, MIDFR

Chart 2: US Unemployment Rate (%) vs Non-Farm Payroll ('000)



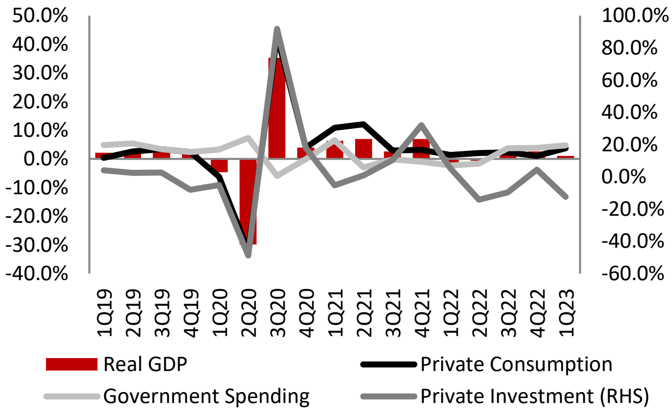
Source: Macrobond, MIDFR

Chart 3: Wage growth (YoY%) vs Unempl. Rate (%)



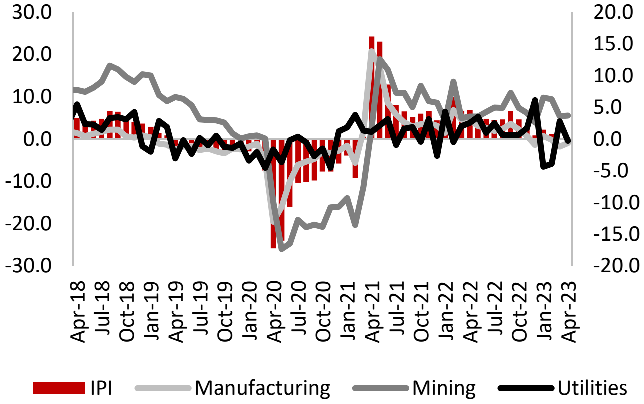
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



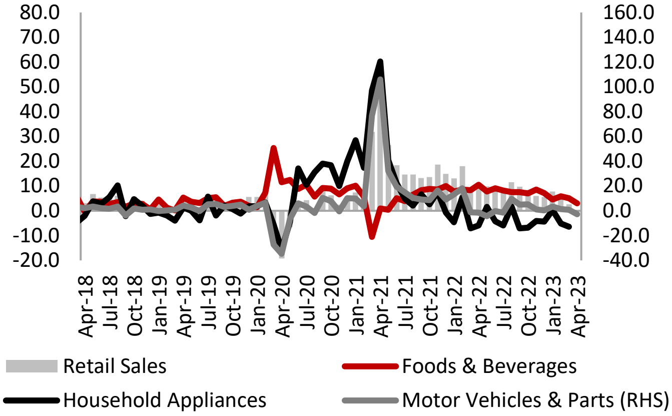
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



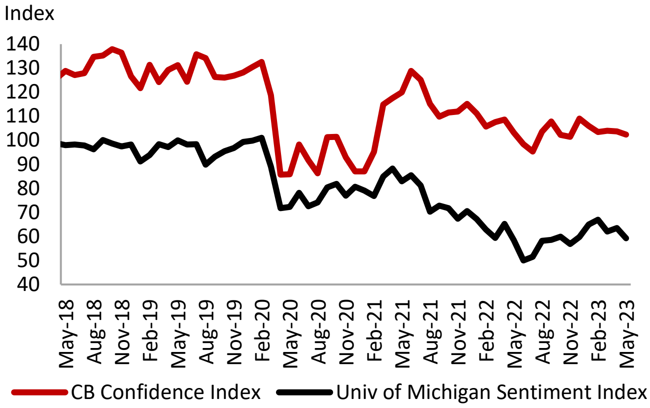
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



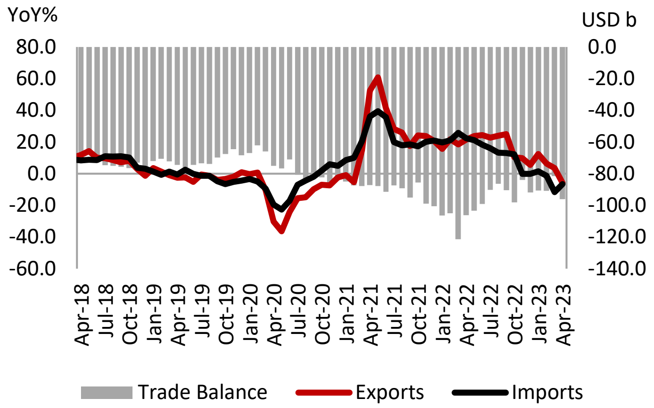
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

Chart 8: US Export & Import (YoY%) vs Goods Trade Balance (USD billion)



Source: Macrobond, MIDFR

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