27 July 2023

ECONOMIC REVIEW | July 2023 US FOMC Meeting

Fed Raises FFR by 25bps as Widely Anticipated and Keeps it Open on Future Hikes

- *Another 25bps hike as widely expected. After the Jul-23 FOMC meeting, the Fed decided to raise fed funds rate (FFR) by additional 25bps to 5.25-5.50%, the highest level in 22 years. The hike was widely anticipated as the Fed remained focused to bring down inflation towards its 2% target.*
- *Fed staff's projection no longer predict recession. Although the FOMC did issue an updated projection on the US economic growth and inflation, Fed Chair Jerome Powell explained that Fed staff's forecast is no longer looking at the US economy to experience recession this year.*
- *No more hike but subject to changes in inflation and economy. We opine the Fed is nearing the end of its tightening cycle. With the Fed keeping it open on its policy direction, the Fed's decisions will be influenced changes in overall macroeconomic situation and future price movement. If inflation moderates further, we opine there is less need for more rate hikes.*

Another 25bps hike as widely expected. After the Jul-23 FOMC meeting, the Fed decided to raise fed funds rate (FFR) by additional +25bps to 5.25-5.50%, the highest level in 22 years. The Fed also reiterated its commitment to shrink the size of its balance sheet (i.e. reduce holdings of securities) as part of its overall policy tightening to contain inflation. The decision to hike by 25bps was widely anticipated as the Fed remained focused to bring down inflation towards its 2% target. The hike was deemed necessary to engineer a more significant disinflation on the back of still tight labour market and resilient US economy, where consumer managed to increase spending even into 1HCY23.

Fed staff's projection no longer predict recession. Although the FOMC did not issue an updated projection on the US economic growth and inflation, the Fed Chair explained that the latest Fed staff's forecast no longer predict the US economy will experience recession this year. Given the continued resilience, the US economy thus far was able to weather the effects of aggressive rate hikes after the cumulative +525bps increases since Mar-22. According to the FOMC statement, the US economy recently has been growing moderately, not much different than the modest growth assessment during the Jun-23 meeting as the job market continued to report job gains and low unemployment rate, while inflation remained elevated. However, Chair Powell highlighted that recent data indicated some cooling in the labour market as well as relatively slower domestic spending from earlier this year.

Job market remained tight. The strength in the job market has been the key factor for the resilience in the US economy. Not only the economy will avoid recession this year, the Fed Chair indicated the progress to bring down inflation towards the Fed's target may be achieved without significant deterioration in the job market. Although labour demand remained strong, he believes the imbalance in the labour market will gradually normalize as more people entered the job market with job creation already slowed compared to last year. He mentioned the slower job growth is a sign of cooling in the labour market, with the nonfarm payrolls rising on average +278K per month in 1HCY23 lower than average monthly increase of +399K last year. Moreover, the number of job openings also declined and nominal wage growth eased further, with the average hourly earnings growing at +4.4% in 2QCY23 which was the slowest rise in 8 quartes. With the unemployment rate still at low level of 3.6% as of Jun-23, the strength in the job market will continue to support consumer spending and the overall resilience in the US economy.

Inflation moderating but remained elevated. While the Fed wanted to see a more significant downtrend in inflation, the US headline CPI inflation continued to ease to +3%yoy (May-23: +4.1%yoy), which was the slowest pace since Mar-21. Excluding food & energy prices, the core CPI inflation also decelerated to +4.8%yoy (May-23: 5.3%yoy), the lowest since Oct-21. Given the moderation in CPI inflation, we foresee core PCE inflation could be lower than +4.6%yoy in Jun-23 after hovering around +4.6-4.7%yoy in the previous 6 months. However, with consumer sentiment having improved on the back of easing inflation, the underlying demand pressures could pose upward price pressures. In addition, rising services charges could translate into stubbornly high inflation, although goods inflation has moderated in line with improved supply and lower commodity prices. Fed Chair Powell indicated the Fed needs to analyze more data to finally conclude iinflation (i.e. core PCE prices) is clearly on a moderating trend, with concerns the future inflation outlook still remained uncertain.

No victory yet in inflation fight, and no rate cuts this year. Despite market expectations that inflation in the US will continue to ease and move lower and closer to Fed's 2% target, Chair Powell reiterated that there will be no rate cuts this year as the effort to bring down inflation is not complete. The interest rates will be kept at restrictive level and the tightening of credit by banks will continue to impose downward pressures on the economy, job market and inflation. Commenting on the rate cuts next year as anticipated by the market, he concluded that it is a possibility and the Fed could consider easing its policy setting even before inflation touches 2%. The decision will be subject to the overall macroeconomic situation and inflation outlook; so, the rate cuts wil be possible only if new data shows more signs of slowdown in the US economy with continued and more significant progress in disinflation closer to Fed's 2% target.

Economic activities will be constrained by tighter credit. Fed Chair also shared that the overall banking sector condition remained healthy and strong. Despite the reduced concerns about the banking sector stability, the Fed continues to closely monitor conditions in the US financial and banking system. Following the rise in interest rates, the high borrowing costs would hurt consumer demand and higher mortgage rates already adversely affected demand and activities in the US housing market. This is expected to continue dampening the aggregate demand in the coming period as the Fed keeps its policy interest rate at restrictive levels.

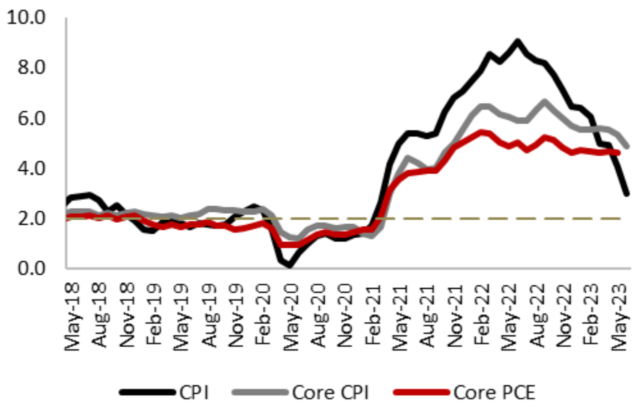
Fed nearing the end of its tightening cycle. Looking at the moderating trend in global and US inflation, we opine the Fed is nearing the end of its tightening cycle. We understand why the Fed reiterated its mandate to maintain price stability so that inflation will continue to decelerate and future inflation expectations will be anchored. In general, with the Fed keeping it open on its future policy direction, the Fed's decisions will be influenced by changes in overall macroeconomic situation and future price movement. If inflation moderates further, there is less need for more rate hikes as the existing setting of FFR already at restrictive level, higher than the recent inflation readings. On ther other hand, if inflation remains elevated and the US economy and job market were to be stronger than expected, more rate hikes will be possible.

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

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

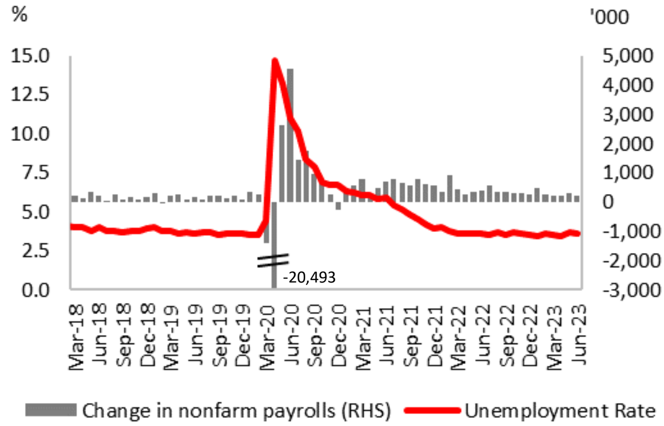
Source: Bloomberg; MIDFR

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



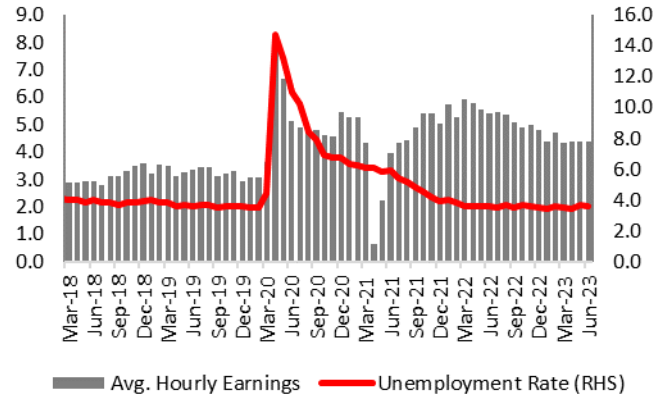
Source: Macrobond, MIDFR

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



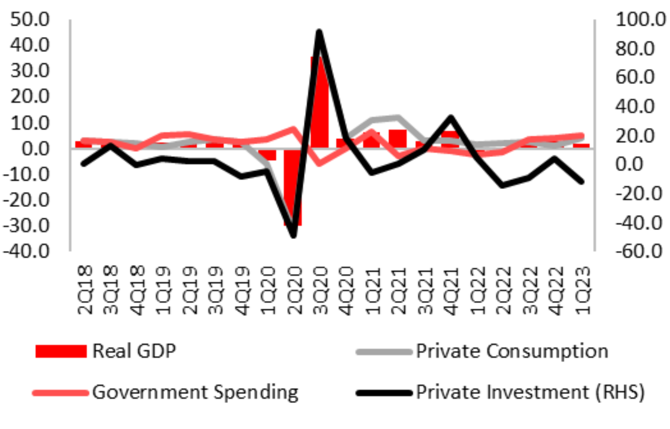
Source: Macrobond, MIDFR

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



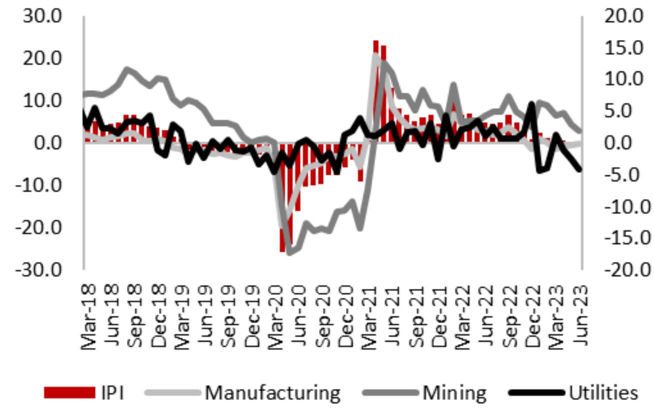
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



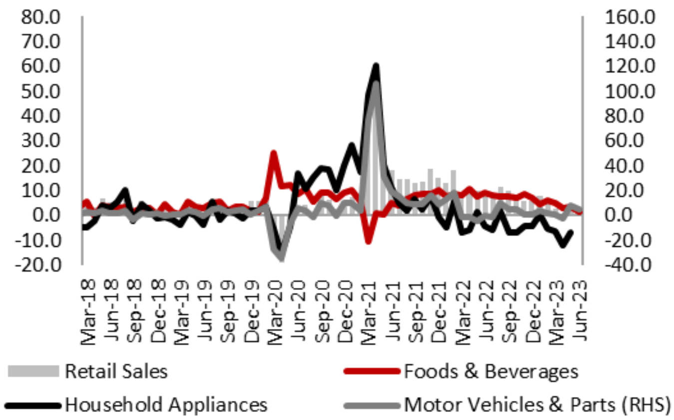
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



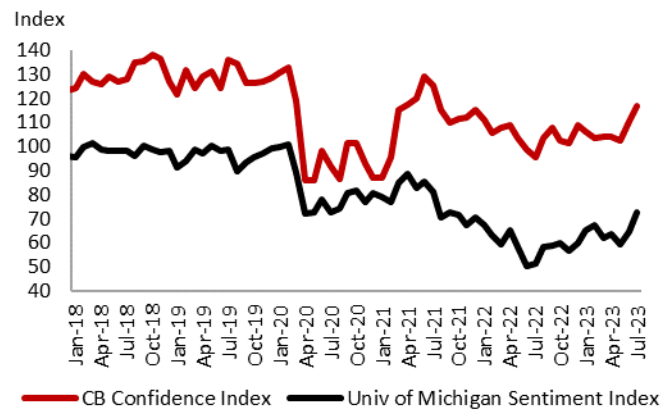
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



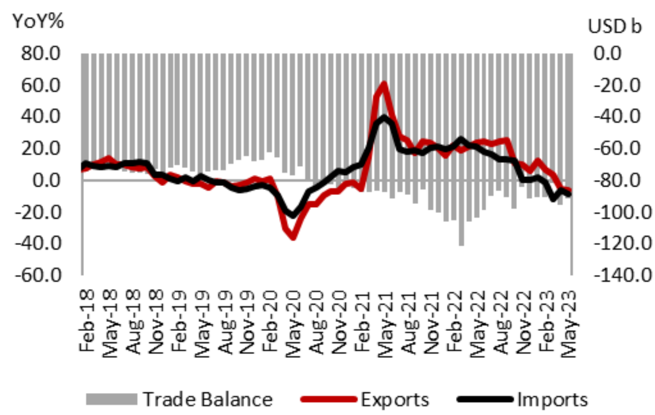
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

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



Source: Macrobond, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077 (23878 – X)).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER