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ECONOMIC REVIEW | September 2023 US FOMC Meeting

Fed Maintained FFR and Kept its Hawkish Stance as Inflation Remained Above Target

- *No change as widely expected. In line with market expectations, the Fed maintained the fed funds rate (FFR) target at 5.25-5.50%. The Fed will keep its policy setting restrictive as inflation remained above its 2% target.*
- *FOMC upgraded its economic projection. Due to the resilience in the economy, the FOMC foresee stronger outlook for the US GDP growth in 2023 and 2024. The Fed now predicts the US economy will experience higher growth of around +2.1% this year (Jun-23 forecast: +1.0%) before moderating to +1.5% in 2024.*
- *Fed to keep interest rates high and restrictive. Despite Fed signalling another hike, we anticipate that there will be no more hike by the Fed as core inflation moderated. As mentioned by Chair Powell, the existing policy setting is already "meaningfully restrictive."*

No change as widely expected. In line with market expectations, the Fed maintained the fed funds rate (FFR) target at 5.25-5.50%. At the press conference, the Fed Chair Jerome Powell indicated that the Fed will keep policy setting restrictive, therefore keeping its hawkish signal, as inflation remained above its 2% target. Apart from keeping FFR unchanged, the Fed reiterated its commitment to reduce holdings of securities as part of its overall policy adjustment as the mission to ease elevated inflation remained incomplete. Despite recent signs of cooling in the job market, the Fed concludes that the US job market is still robust and labour demand remained strong. Even after the aggressive rate hikes, cumulative increase in FFR by 525bps since Mar-22, the US economy continued to show resilience having performed better than the expected.

FOMC upgraded its economic projection. Due to the resilience in the economy, the FOMC foresee stronger outlook for the US GDP growth in 2023 and 2024. The Fed now predicts the US economy will experience higher growth of around +2.1% this year (Jun-23 forecast: +1.0%) before moderating to +1.5% in 2024 (Jun-23 forecast: +1.1%). With the upgraded growth outlook, the Fed projects the deterioration in the job market will not be as fast as previous anticipated as the unemployment rate is expected to increase to 3.8% this year (Jun-23 forecast: 4.1%) and will only rise to 4.1% next year (Jun-23 forecast: +4.5%). While the projected level of FFR remained unchanged at 5.6% for this year, which reflects the FOMC members' view there may be another hike this year, we find it surprising that the Fed did not project a quicker reduction of FFR to more normal levels as the outlook for FFR is raised to 5.1% for 2024. This means the Fed will only consider 1-2 rate cuts next year although core PCE inflation is projected to fall further to +2.6% (same forecast as in Jun-23 projection). The Fed even upgraded its inflation outlook for 2023, anticipating a quicker disfinlation this year as core PCE inflation would ease to +3.7% (Jun-23 forecast: +3.9%).

Several challenges to the economic outlook. Chair Powell highlighted several downside risks which could affect the US economy. He mentioned few factors that could affect the economic stability which include the recent strikes affecting production activities in the US, renewed concerns about potential government shutdowns, ongoing issues related to the student loans, potential shocks from high oil prices and keeping interest rates high for longer period. All these uncertainties could affect the US economic outlook as well as the course of the Fed's future policy setting. However, he concluded that the macroeconomic picture remained strong, and the Fed will require more data to determine how much recent developments affected the US economic activities, including the actual impact on productions and hirings.

Consumer still spending. The latest data shows American consumers continued to spend. Retail sales grew by +2.6% in July-August 2023, a pick-up from 12-quarter low of +1.6%yoy growth in 2QCY23. As inflation moderated, sequential data also showed real personal consumption expenditures rose faster at +0.6%mom in Jul-23 (Jun-23: +0.4%mom; May-23: +0.1%mom) as consumers spent more on both goods (+0.9%mom) and services (+0.4%mom). All this pointed to the continued resilience in the economy, as consumption accounted more than 70% of the US GDP, and despite the Fed having increased interest rates to high levels. With relatively more moderate inflation, consumer confidence surveys showed better sentiment (or reduced pessimism) among consumers. We opine that further easing in the US inflation will therefore be positive to consumers and their future spending plans.

Job market cooled but still robust. The strength in the job market and positive wage growth supported consumer spending, and remained as key factor to the US economic resilience thus far. Despite recent data showing some cooling, overall US labour market condition remained robust. More jobs were created as the nonfarm payrolls increased further by +187K in Aug-23 (Jul-23: +157K), albeit not as strong as +256.7K per month in 6MCY23 and +399.4K per month in 2022. Moreover, the Job Openings and Labor Turnover Survey (JOLTS) showed the number of job openings declined to 8.83m in Jul-23 (Jun-23: 9.17m), lower than 11.38m a year ago. Nominal wage growth also eased further to +4.3%yoy in July-August 2023 (2QCY23: +4.4%yoy; 3QCY22: +5.3%yoy. Although jobless rate rose to 3.8% in Aug-23, the highest since Feb-22, this was partly due to to more people entering the job market as labour force participation rate climbed to 62.8% (Jul-23: 62.6%), the highest since early 2020. This indicates reduced tightness in the job market, with no significant uptrend in initial claims for unemployment benefits, which still hovered around 220K-240K.

Inflation moderated but remained above Fed's target. The US headline CPI inflation rose to +3.7%yoy in Aug-23 (Jul-23: +3.2%yoy), the second month of acceleration following the recent rise in oil prices which led to slower energy price deflation. Core CPI inflation, on the other hand, eased futher to +4.3%yoy (Jul-23: +4.7%yoy), the slowest since Sep-21. With the core inflation moderating further, we anticipate the core PCE inflation will be following the same trend, despite the slight increase to +4.2%yoy in Jul-23 (Jun-23: +4.1%yoy). As inflation moderated further, Chair Powell mentioned that inflation expectations have been well anchored. For example, according to the preliminary finding in Sep-23, the University of Michigan's survey on consumer sentiment found that Americans expected the 1-year inflation outlook will be slower at +3.1% (Aug-23 survey: +3.5%). In the survey conducted by the New York Fed in Aug-23, Americans indicated inflation will increase by +3.6% in the next 12 months, slightly higher than +3.5% indicated in the previous month but well below +5.7% when the survey was conducted 12 months ago in Aug-22.

Soft landing a plausible outcome, Fed signals for another hike. The Fed Chair shared his assessment the soft landing is a "plausible outcome" as the economy remained strong and the Fed remained focus on bringing down inflation. With interest rates to be maintained at high levels for a longer period, aggregate demand and job market will eventually soften, which is the Fed's formula to ensure continued moderation in the US inflation. As labour market conditions remained encouraging, consumers would continue to increase spending as easing inflation may translate into improved sentiment. On the back of stronger-than-expected economic growth, this explains why the Fed continues to signal another hike this year should inflation not easing further and remain stubbornly elevated. This is reflected in the dot-plot projection which shows the FOMC members still predict another hike later this year, though it will be subject to future data i.e. the near-term inflation outlook and overall strength of the economy.

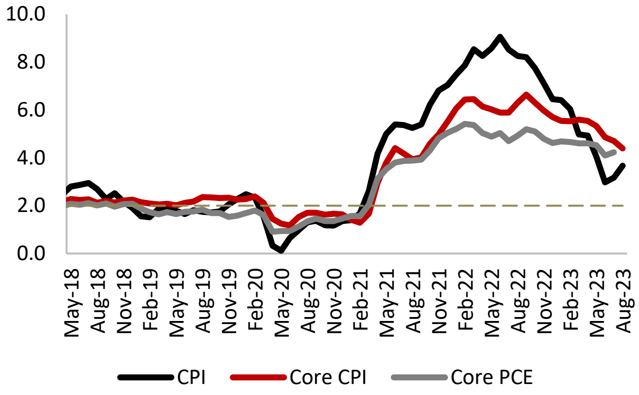
Fed to keep interest rates high and restrictive. Despite Fed signalling another hike, we anticipate that there will be no more hike by the Fed as core inflation moderated. As mentioned by Chair Powell, the existing policy setting is already "meaningfully restrictive" with positive real interest rates to constrain credit growth and the economy, which will then push inflation lower. We believe the Fed is already at the end of its policy tightening as inflation expectations also showed Americans anticipate a more easing inflation pressures in the coming year. Once again, we reiterate 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, given the continued strength in the US economy and the job market, the Fed has the room to raise rates to engineer a more significant disinflation if price pressures remains elevated.

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

	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23
Malaysia	2.75	2.75	2.75	2.75	3.00	3.00	3.00	3.00	3.00
Indonesia	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75
Philippines	5.50	6.00	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Thailand	1.50	1.50	1.75	1.75	2.00	2.00	2.00	2.25	2.25
Vietnam	6.00	6.00	6.00	5.50	5.00	4.50	4.50	4.50	4.50
South Korea	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
India	6.25	6.50	6.50	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	3.50	4.00	4.25	4.25	4.50	5.00	5.00	5.25	5.25
Euro area	2.50	3.00	3.50	3.50	3.75	4.00	4.25	4.25	4.50
US	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	5.25-5.50	5.25-5.50

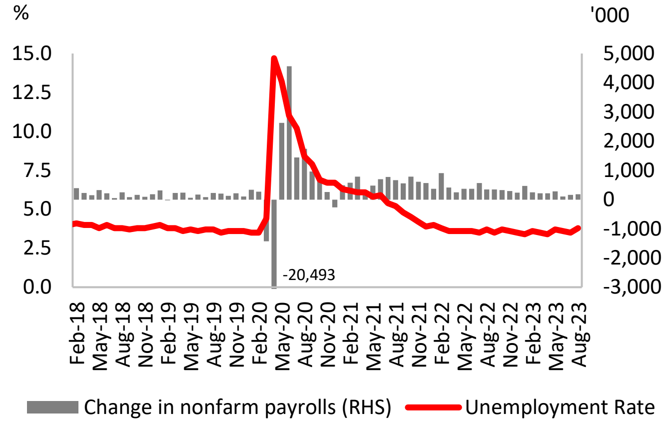
Source: Bloomberg; MIDFR

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



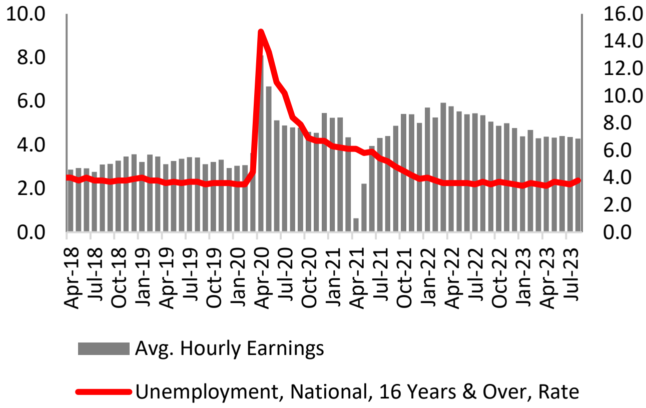
Source: Macrobond, MIDFR

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



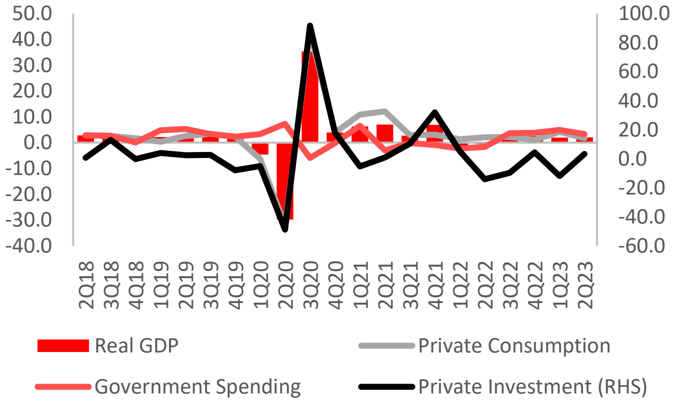
Source: Macrobond, MIDFR

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



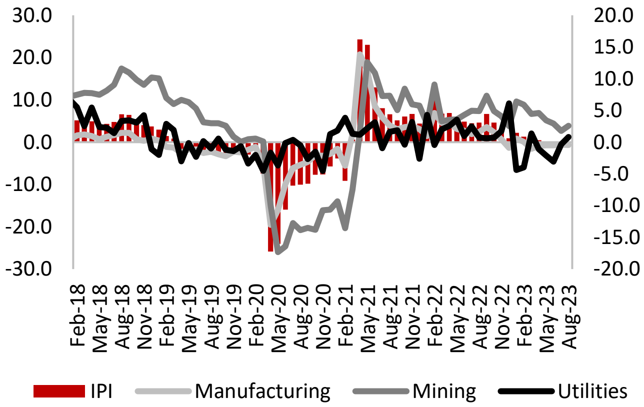
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



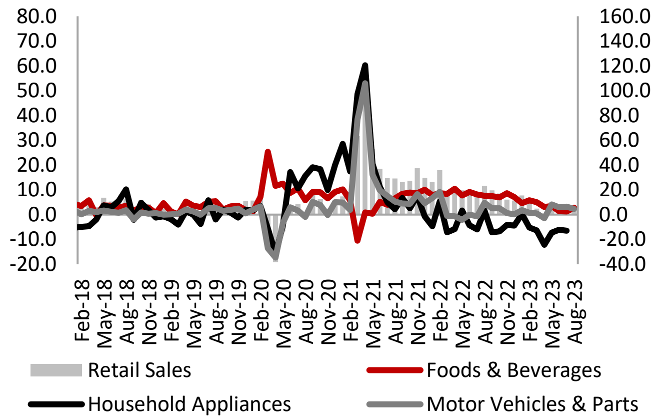
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



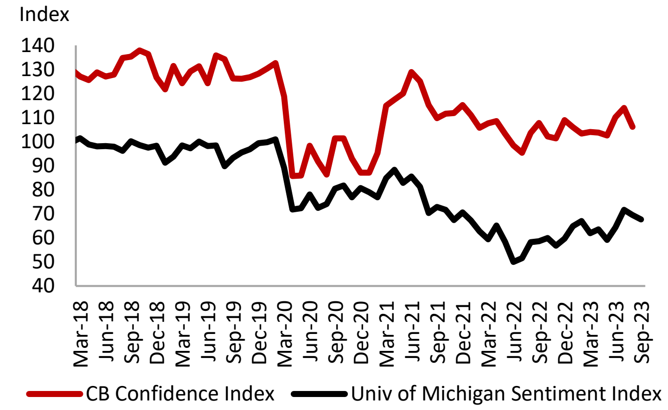
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



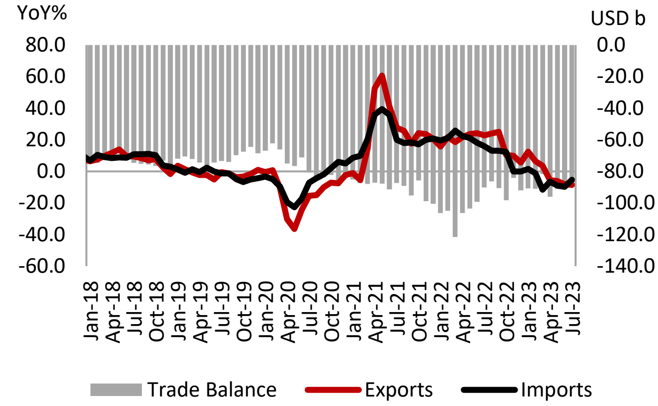
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

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



Source: Macrobond, MIDFR

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