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ECONOMIC REVIEW | November 2023 US FOMC Meeting

Fed Kept FFR Target Unchanged at 5.25-5.50% Despite the Resilience in the US Economy

- *Maintain FFR at 5.25-5.50% as widely expected. The Fed's FOMC decided to maintain the fed funds rate (FFR) target at 5.25-5.50%, in line with the overwhelming expectations in the market for 'no change.'*
- *No change to growth projection, but the economy has been strong. The latest meeting does not come with revised projection to reflect the FOMC members updated economic projection. Given the continued resilience in the US economy, the Fed staff baseline projection did not include the possibility of recession.*
- *Keeping interest rates restrictive for longer. With inflation moderating, we believe there is reduced need for the Fed to raise rate to higher levels. Therefore, the Fed is expected to maintain the fed funds rate target unchanged at 5.25-5.50% even at the next meeting.*

Maintain FFR at 5.25-5.50% as widely expected. The Fed's FOMC decided to maintain the fed funds rate (FFR) target at 5.25-5.50%, in line with the overwhelming expectations in the market for 'no change.' Nevertheless, the Fed reiterated that it would continue to reduce its balance sheet, thus far the Fed's holdings of securities has been reduced by more than USD1 trillion from the peak back in Apr-22. As the Fed remains focused on its current mission to bring down inflation, the high restrictive rate is expected to be kept for longer period. Reading from the message from the Fed Chair at the post-meeting press conference, we conclude that the strength in the US economy provide rooms for the Fed to still consider for more rate hike if inflation is not moving lower and sustainably downward towards the Fed's 2% target.

No rate cuts being discussed. In his response about potential rates and the expectation on future FOMC decisions in the next meetings, Chair Powell indicated that the Fed did not discuss rate cuts. At this point, the Fed is still focused on containing inflation which remained above the Fed's price stability target. In fact, the Fed Chair even clearly mentioned in his official statement that the decision by the Fed to keep the tight monetary policy is to pose "downward pressure" on the economy as well as inflation, where the impact from the Fed's aggressive tightening and restrictive policy since last year has "yet to be felt." In other words, the strength in the US economy somehow has been performing better than expected, while the +525bps rate hikes should have caused the economy to slow as the strategy to push inflation lower.

No change to growth projection, but the economy has been strong. The latest meeting does not come with revised projection to reflect the FOMC members updated economic projection. The Fed Chair even warned against using the dot plot as a strict guidance for the FOMC on its future decisions as the FOMC projection only reflected the expectations and forecast of all FOMC members at the time of the meeting, therefore the updated views may change considering the latest indicators. The Fed Chair even refused to indicate any potential decision at the upcoming FOMC meeting, where he mentioned at the next meeting in Dec-23, for example, the Fed will definitely consider the latest updates on the strength of the US economy and 2 more updates on the labour market i.e., for Nov-23 and Dec-23. Given the continued resilience in the US economy, the Fed staff baseline projection did not include the possibility of recession.

The US economy remained resilient. The FOMC described the recent performance of the US economy as stronger than expected. Given the continued resilience in the US economy, the US economy grew strongly at annualized +4.9%qoq in 3QCY23 (2QCY23: +2.1%qoq) mainly due to the pick-up and robust growth in in consumer spending (3QCY23: +4.0%qoq; 2QCY23: +0.8%qoq). However, the high interest rates already put downward pressures on fixed investment as well as the US housing market, where the level of activities remained below last year. While the strength in the labour market helped to support consumer spending, we also conclude that the easing inflation also helped to boost consumer confidence as inflation expectations anchored to lower levels. This can be seen in both surveys on consumer confidence where the Conference Board Consumer Confidence Index and the University of Michigan Consumer Sentiment Index both averaged higher in 3QCY23 at 109 (2QCY23: 105.4) and 69.6 (2QCY23: 62.3), respectively.

The job market is still strong despite rebalancing. The robust and tight job market remains the key reason behind the US economic resilience. According to the Fed, there have been signs of cooling and rebalancing, as job creation has been relatively slower with the nonfarm payrolls rising +266K per month in 3QCY23 which was lower than average monthly increase of +399.4K in 2022. Labour demand remained strong, although the Job Openings and Labor Turnover Survey (JOLTS) showed the number of job openings remained stable at 9.55m in Sep-23 (Aug-23: 9.50m), but the number has averaged lower at 9.7m per month in 9MCY23 lower (average 2022: 11.2m per month). Nominal wage growth also eased further to +4.2%yoy in 3QCY23 (2QCY23: +4.4%yoy; 2QCY22: +5.6%yoy) but remained high relative to the pre-pandemic (2019: +3.3). Although the rebalancing also saw the jobless rate climbing to 3.8% in Aug-23 and Sep-23 from the low of 3.4% in Apr-23, the low claims for unemployment benefits indicated no sharp deterioration in the US job market.

Fed sees "long way" to bring down inflation to 2%. Following the Fed aggressive rate hikes, there has been progress in bringing down inflation to lower level. The core PCE prices, the Fed's preferred inflation measure, continued to ease to +3.7% in Sep-23, the lowest reading since May-21. This shows the demand pressures on the US inflation have eased from the peak in Feb-22 when the core PCE inflation was at +5.6%yoy. At the current level in Sep-23, it matches the FOMC's Sep-23 projection that core PCE inflation will ease to +3.7% this year. Although the elevated commodity prices may cause headline inflation to accelerate again, we foresee the moderating core inflation will continue given expectations that the US aggregate demand will slow going forward because of the restrictive financial conditions.

Uncertain on the impact of geopolitical risk in the Middle East. Chair Powell indicated that the effect from the recent conflict in the Middle East on the economy is still unclear. Although it is viewed as one of risks to the growth outlook, according to the Fed Chair it is unclear how the situation will pose a significant impact to the economy. We believe the conflict in the Middle East needs to be monitored closely. Like the war in Ukraine, it could affect commodity prices and supplies, and another surge in energy prices, for example, will have a direct effect on price outlook and adverse impact on consumer sentiment and spending plans.

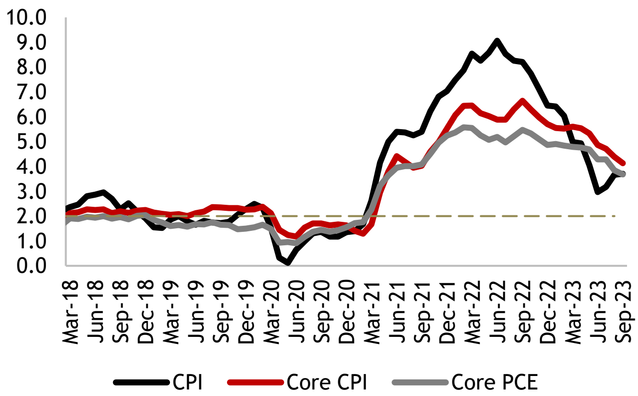
Keeping interest rates restrictive for longer. With inflation moderating, we believe there is a reduced need for the Fed to raise rates to higher levels. Therefore, the Fed is expected to maintain the fed funds rate target unchanged at 5.25-5.50% even at the next meeting. However, given the elevated, we foresee the Fed will keep its restrictive monetary policy going into next year to ensure inflation would "sustainably" disinflation towards the 2% target. Although the FFR target is unchanged, the reduction in the Fed's holding of securities will continue to contribute to the quantitative tightening, in addition to the increase in the US treasury yields, indicative of tighter financial conditions. We believe the deterioration in the job market will be the main determinant that will signal a slowdown in the US aggregate demand which the Fed intends to achieve. This will support for possible policy easing likely in 2H next year, with the assumptions demand condition will slow and inflation to moderate further to lower levels.

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

	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
Malaysia	2.75	2.75	3.00	3.00	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	6.00	6.00
Philippines	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.50	6.50
Thailand	1.75	1.75	2.00	2.00	2.00	2.25	2.50	2.50	2.50
Vietnam	6.00	5.50	5.00	4.50	4.50	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	6.50	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	4.25	4.25	4.50	5.00	5.00	5.25	5.25	5.25	5.25
Euro area	3.50	3.50	3.75	4.00	4.25	4.25	4.50	4.50	4.50
US	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	5.25-5.50	5.25-5.50

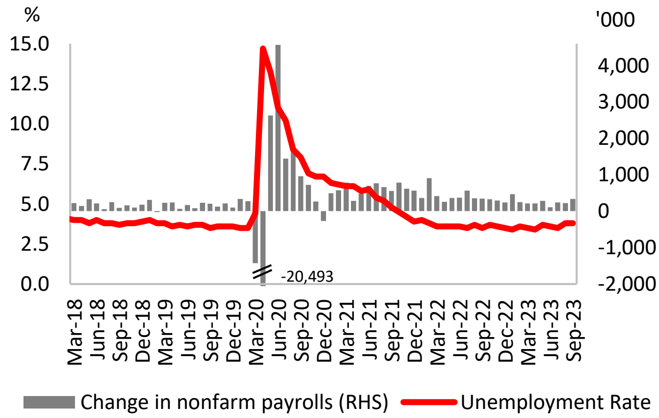
Source: Bloomberg; MIDFR

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



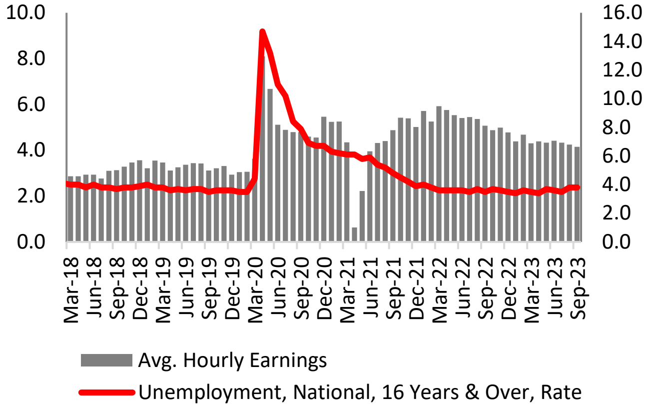
Source: Macrobond, MIDFR

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



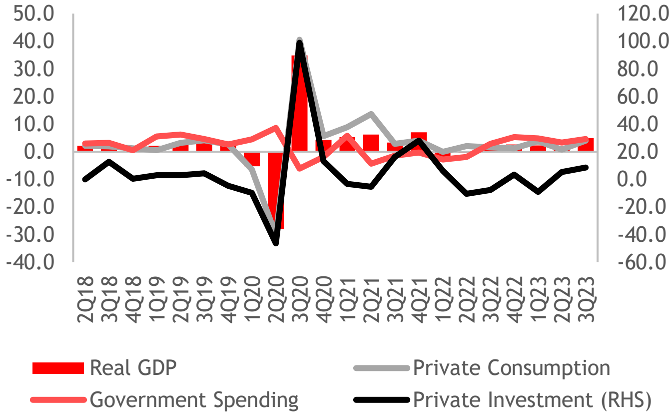
Source: Macrobond, MIDFR

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



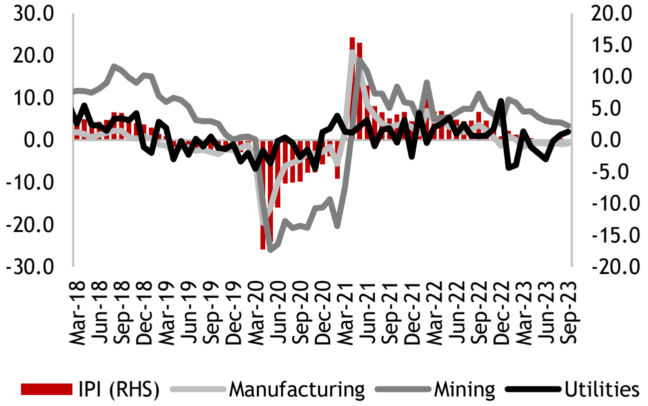
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



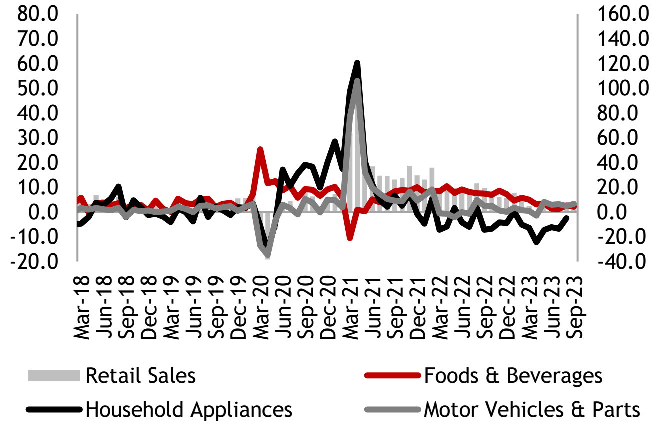
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



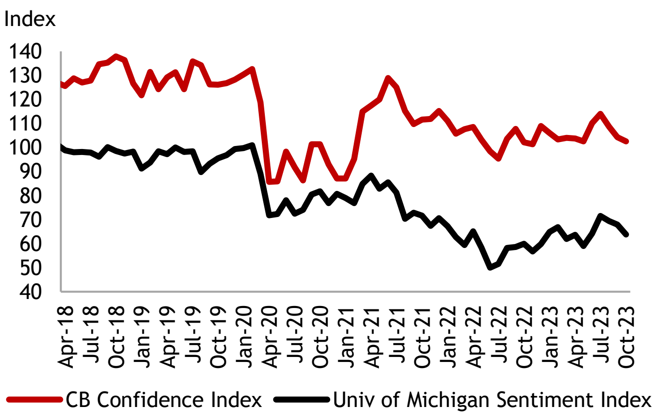
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



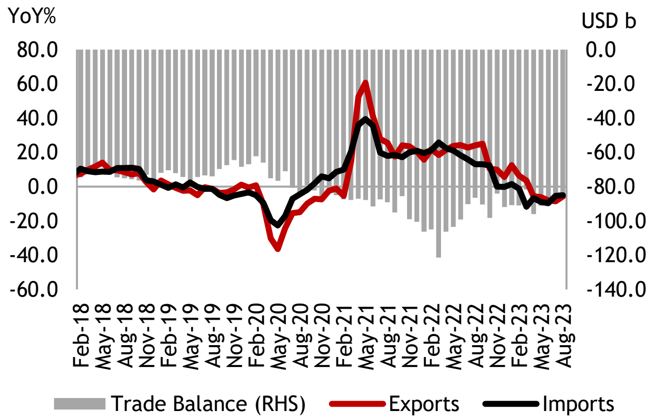
Source: Macrobond, MIDFR

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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