14 December 2023

ECONOMIC REVIEW | December 2023 US FOMC Meeting

Fed Kept Fed Funds Rate High but Signaled More Rate Cuts Next Year

- *No surprise, FFR unchanged at 5.25-5.50%. The Fed's FOMC kept the fed funds rate (FFR) target unchanged at 5.25-5.50%. The decision was as predicted by the market consensus as the Fed is perceived to have reached the end of its policy tightening cycle.*
- *FOMC predicts "growth to cool" next year. The FOMC members continued to expect the US economy to slow next year, with GDP growth to moderate to +1.4% (previous forecast: +1.5%) from estimated growth of +2.6% in 2023 (previous forecast: +2.1%).*
- *Expectation of quicker policy easing. The FOMC expects a quicker rate cuts as the fed funds rate is projected to be slashed to 4.6% by end-2024 and 3.6% in 2025.*
- *Fed to begin cutting rates next year. We expect the Fed will maintain the existing policy setting until at least 1HCY24. Moving into 2HCY23, we foresee the slower growth and weaker aggregate demand will allow the Fed to begin to ease the policy restrictiveness and begin to cut fed funds rates.*

No surprise, FFR unchanged at 5.25-5.50%. The Fed's FOMC kept the fed funds rate (FFR) target unchanged at 5.25-5.50%. The decision was as predicted by the market consensus as the Fed is perceived to have reached the end of its policy tightening cycle. In a way, the Fed signaled the end of rate hikes as the FOMC predicted a quicker reduction for fed funds rate in the coming years. However, given the Fed's focus to push inflation to lower levels, the Fed still did not rule out the possibility of more hikes. If inflation remains persistently elevated and sticky, additional rate hikes may be necessary to reduce inflation to the Fed's target of 2%. In addition to keeping the policy rate unchanged, quantative tightening still continues as the Fed reiterated the continuation of its balance sheet reduction, which has decreased by more than USD1.2t from the peak in mid-Mar-22.

Substantial slowdown in economic activities recently. During the post-meeting press conference, the Fed Chairman shared that recent economic activities in the US economy had slowed "substantially" from the strong annualized growth of +5.2%qoq in 3QCY23. We find the same assessment to be the same as highlighted in the recent Beige report, published couple weeks ago. Based on GDPNow estimate, published by the Atlanta Fed, the US economy is forecasted to grow at annualized +1.2%qoq in 4QCY23.

FOMC predicts "growth to cool" next year. The FOMC members continued to expect the US economy to slow next year, with GDP growth to moderate to +1.4% (previous forecast: +1.5%) from estimated growth of +2.6% in 2023 (previous forecast: +2.1%). The revised FOMC projection also pointed to further easing in inflation next year, with the core PCE inflation to reach +2.4% (previous projection: +2.6%). Moreover, the slowdown will come with deterioration in the labour market as the jobless rate is projected to increase to 4.1% next year, no change from previous projection in Sep-23.

Expectation of quicker policy easing. In terms of the policy setting, the FOMC members projected the fed funds rate will be slashed to 4.6% by end-2024, possibly 3 rate cuts or -75bps reduction. The updated forecast signals a quicker rate reduction may be considered next year vis-à-vis the FOMC's previous forecast which only assumed fed funds rate to be reduced to 5.1%. Given the expectations the US inflation will moderate further, the latest FOMC projection also anticipates the policy rate can be reduced further to 3.6% in 2025 (previous forecast: 3.9%).

Inflation broadly on moderating trend. The inflation trend in the US continued to be on moderating trend, as the headline CPI inflation eased further to +3%yoy in Nov-23 (Oct-23: +3.3%yoy) and despite the core CPI inflation remained unchanged at +4%yoy. If we look at the 5-month average to Nov-23, both headline and core CPI inflation eased further to +3.4%yoy (1HCY23: +4.9%yoy; 2HCY22: +7.7%yoy) and +4.2%yoy (1HCY23: +5.4%yoy; 2HCY22: +6.1%yoy). In particular, the easing core inflation indicated reduced demand-driven price pressures. We expect the economic slowdown, which is expected to be recorded next year, will translate into further moderation in the US inflation. The Fed Chairman claimed that the aggressive policy tightening thus far has successfully brought down inflation lower without causing a sharp deterioration in the job market and the overall economy. If this progress can be maintained, we view this as indication of soft landing, moderating from the better-than-expected and more resilient growth this year.

Tight job market has eased. Although the economy continued to add more jobs, with the nonfarm payrolls increased by +199K in Nov-23, the number of job growth remained below +299K average monthly growth in 2022. If we look at the level of stress in the job market, we noticed little signs of deterioration based on the levels of new claims for jobless benefits, which remained at low levels and hovered around +200K to +220K in the recent weeks. The unemployment rate also remained low, falling to 3.7% in Nov-23 (Oct-23: 3.9%). However, as indicated by the Beige Book, labour demand has dropped. This is also backed by the reduced number of job openings, according to the JOLTs report by the US Bureau of Labor Statistics (BLS), which dropped to 8.73m in Oct-23, the lowest since Mar-22. Nevertheless, the Fed deemed the level of labour demand continued to exceed labour supply. Given positive real wage growth as inflation now fell below the wage growth (average 5-month to Nov-23: +4.2%yoy), we expect American firms would continue to reduce labour demand constrained by pressures from labour costs and and high interest rates. The hiring will also slow as firms react to the slower demand.

From inflation to growth concerns. As the Fed intended to engineer a demand slowdown, the policy focus will eventually shift towards reducing the restrictiveness on the economy and minimizing the risk of sharp slowdown. Looking at the economic resilience this year, the economy adapted to the aggressive tightening as the tight labour market and positive wage growth supported consumer spending, which is the main driver of US economic growth. The resilience in the economy also led to expectations that the economy will only experience soft landing, with growth to remain in positives but below trend next year. Demand conditions and labour demand could slow further going into 2024 constrained by the tighter financial conditions. On that note, we foresee the Fed's narrative will focus more about policy easing to support the economy as overly restrictive policy is no longer needed. Moreover, the slowdown in demand (and growth) will ensure inflation will continue to trend lower. Keeping interest rates at high levels for too long could derail growth and risk going into recession or "hard landing."

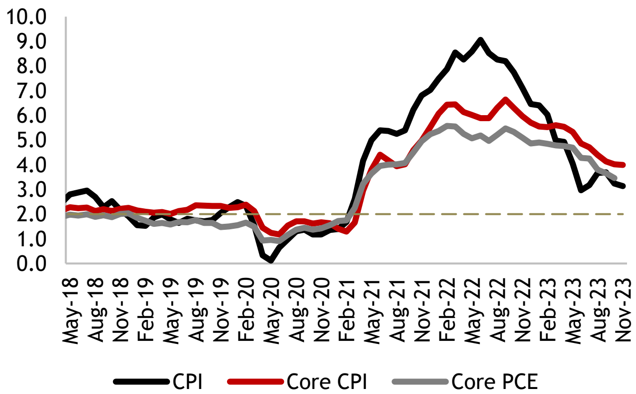
Fed to begin cutting rates next year. Given inflation still remained above the Fed's 2% target and recent data somehow suggests core CPI inflation remained sticky, we expect the Fed will maintain the existing policy setting until at least 1HCY24. Moving into 2HCY23, we foresee the slower growth and weaker aggregate demand will allow the Fed to begin to ease the policy restrictiveness and begin to cut fed funds rates. This will be subject to the overall strength in the US economy, mainly consumption spending outlook. We expect the job market and wage growth will be the important data to be monitored closely to gauge the health of aggregate demand and ability of consumers to sustain their spending activities. The delayed effect monetary policy tightening also suggests the economy will experience slower growth next year as both consumers and businesses are hit by the high borrowing costs. If growth were to slow sharply, the Fed may consider larger rate cuts and adopt accommodative policy to stimulate the economy.

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

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

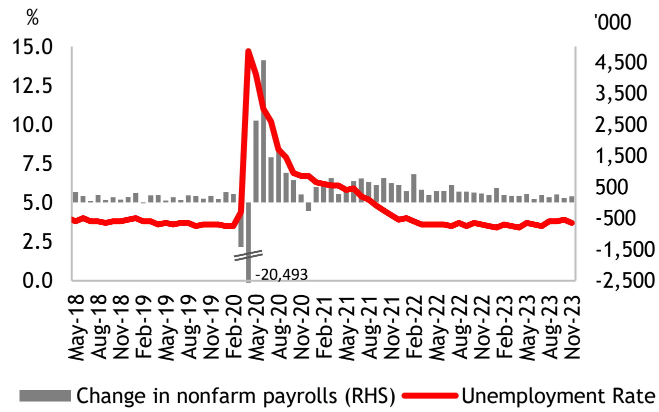
Source: Bloomberg; MIDFR

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



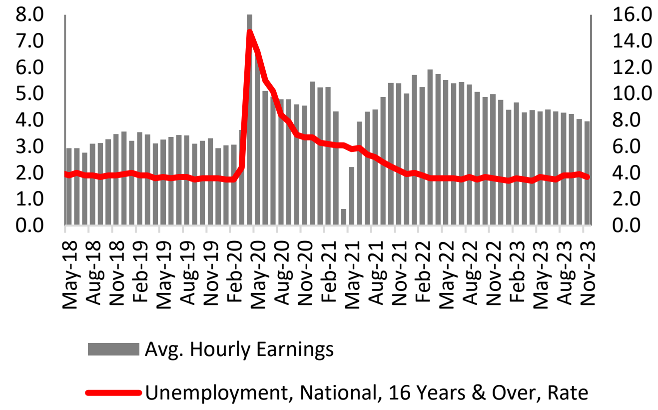
Source: Macrobond, MIDFR

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



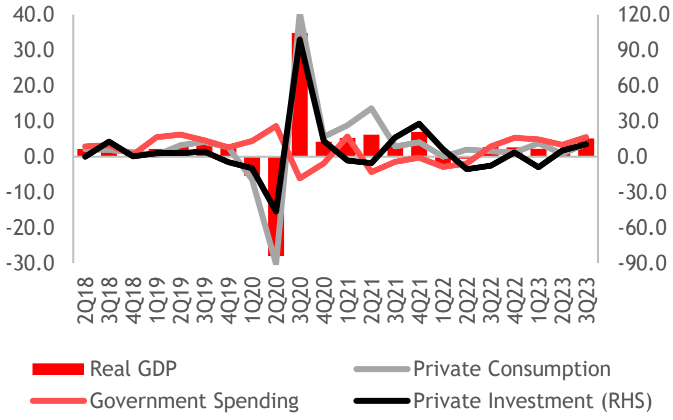
Source: Macrobond, MIDFR

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



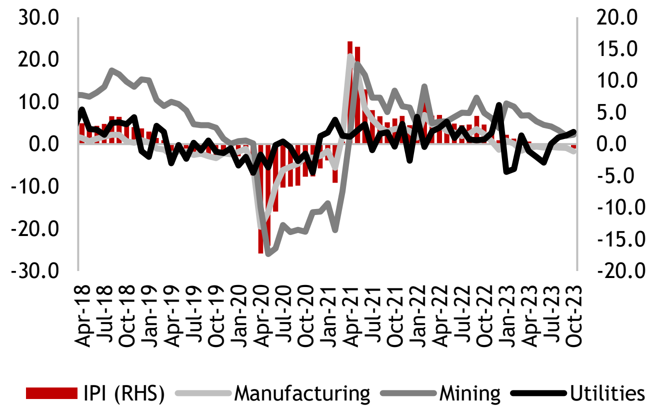
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



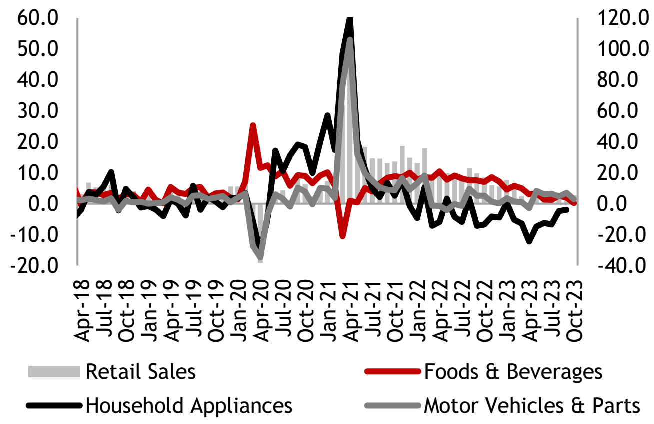
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



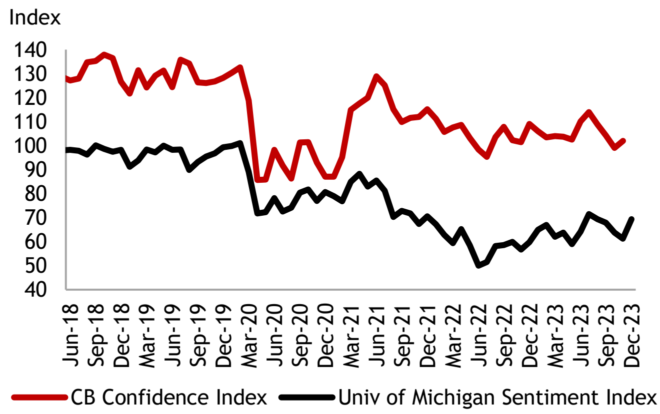
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



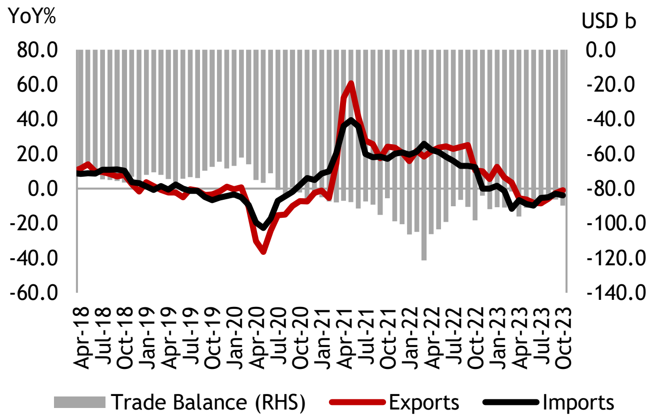
Source: Macrobond, MIDFR

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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