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2 May 2024

ECONOMIC REVIEW | May 2024 US FOMC Meeting

No Change to Fed Funds Rate as Fed Keeping Restrictive Policy Amid Sticky Inflation

- *Fed keeps rates unchanged as widely expected. The Fed's FOMC maintained its benchmark fed funds rate (FFR) at the existing range of 5.25-5.50%. The decision was not a surprise with the market consensus anticipating for no change to the policy setting as the right response to the still elevated inflation.*
- *Additional rate hike unlikely as the current policy is already restrictive. At the press conference, the Fed Chair Jerome Powell responded that there is no need for more rate hikes as the current policy setting is deemed restrictive on the US economy.*
- *Inflation stickier than expected. Elevated inflation remained the major consideration for the FOMC to maintain the existing level of policy restrictiveness. The FOMC added that the US inflation showing "a lack of further progress" recently to moderate further towards the Fed's 2% target.*
- *We still expect rate cut this year. We continue to foresee the possibility for the Fed to reduce FFR in the latter part of 2HCY24. On the other hand, continued resilience in the US economy and persistently elevated inflation outlook could further delay the Fed's decision to cut interest rates to a later period.*

Fed keeps rates unchanged as widely expected. The Fed's FOMC maintained its benchmark fed funds rate (FFR) at the existing range of 5.25-5.50%. The decision was not a surprise with the market consensus anticipating for no change to the policy setting as the right response to the still elevated inflation. While Fed stressed adjusting the FFR remained the Fed's main policy tool, the Fed indicated that it will continue its quantitative tightening, bascially shrinking its balance sheet further by reducing its holdings of financial securities (i.e. Treasury and mortgage-backed securities). The pace of monthly reduction for the treasury securities, however, will be slowed to USD25b (current pace: -USD60b a month) starting 1 June 2024. Since the peak in Apr-22, the size of the Fed's balance sheet has dropped approximately USD1.56t.

Additional rate hike unlikely as the current policy is already restrictive. At the press conference, the Fed Chair Jerome Powell responded that there is no need for more rate hikes as the current policy setting is deemed restrictive on the US economy. The previous policy tightening has also brought adjustments such as bringing down inflation from the recent peaks and easing tightness in the labour market. In other words, he believes the current policy setting is appropriate given the recent macroeconomic developments. Chair Powell also reiterated that it would be ideal if inflation would ease further without hurting the economy or the job market.

US economy still resilient… The FOMC statement repeated the same assessment that the US economy continued to experience "solid expansion". Despite the weaker-than-expected GDP growth in 1QCY24 based on the advance estimate, consumer spending continued to grow on the back of low unemployment and positive wage growth. To note, there was no update on the FOMC's economic projection. However, given the recent growth trend, we foresee a high chance the US economy would grow this year stronger than +2.1% projected by the FOMC in Mar-24. This indicates the US economy will likely grow this year at its normal pace.

…and inflation stickier than expected. Elevated inflation remained the major consideration for the FOMC to maintain the existing level of policy restrictiveness. The FOMC added into its post-meeting statement that the US inflation showing "a lack of further progress" recently to moderate further towards the Fed's 2% target. In other words, the FOMC concluded that the recent price development had been stickier than expected, with the core PCE inflation remained unchanged at +2.8%yoy in Mar-24. On that note, Chair Powell anticipated the Fed would take longer time to be confident that the US inflation is easing and moving closer to its longer-term target.

Still strong job market. Following adjustment after the policy tightening, conditions in the US job market according to the Fed have been more consistent with the pre-pandemic period. The tight condition in the job market has eased, mainly reflected by the reduced labour demand with the number of job openings falling further to 8.49m as of Mar-24, the lowest in 3 years. In addition, wage growth also moderated as the average hourly earning rose by +4.1%yoy in Mar-24, the slowest rise since Jul-21. Nevertheless, job growth was robust following the stronger rise in nonfarm payrolls by +829K in 1QCY24, the fastest in 4 quarters. The strong job growth in Mar-24 also pushed the jobless rate lower to 3.8% from 3.9% in Feb-24, which was the highest reading in 25 months due to the rebalancing in the job market. The recent trend in the initial jobless claims also indicated no deterioration in the US job market; weekly filings hovered around 210.9K thus far this year (average in 2023: 222.8K per week). We expect the robust job market will continue to support US consumer spending and the US overall economic growth this year.

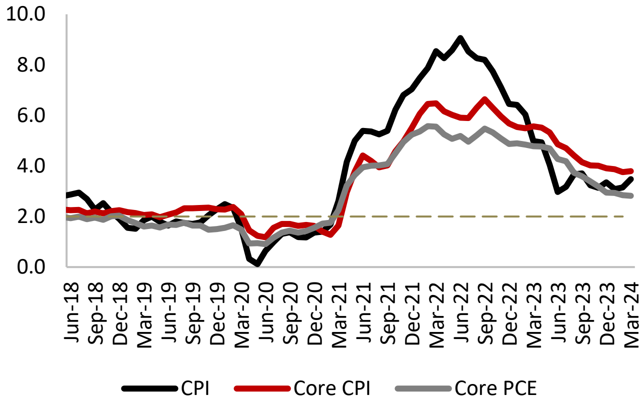
We still expect rate cut this year. We continue to foresee the possibility for the Fed to reduce FFR in the latter part of 2HCY24. Despite inflation remained above the Fed's target, we view the US inflation is broadly on a moderating trend, having declined from the recent peak in early 2022. In addition, we expect the prolonged restrictive policy will eventually constrain the US aggregate demand to soften and therefore further reduce demand-driven inflationary pressures. So, if inflation moves sharply lower and the US economic conditions deteriorate significantly, the Fed could switch to policy easing to support the economy. On the other hand, continued resilience in the US economy and persistently elevated inflation outlook could further delay the Fed's decision to cut interest rates to a later period.

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

	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Indonesia	5.75	6.00	6.00	6.00	6.00	6.00	6.00	6.25	6.25
Philippines	6.25	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Thailand	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Vietnam	4.50	4.50	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)	0.00-0.10	(0.10)	0.00-0.10
UK	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25
Euro area	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
US	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50

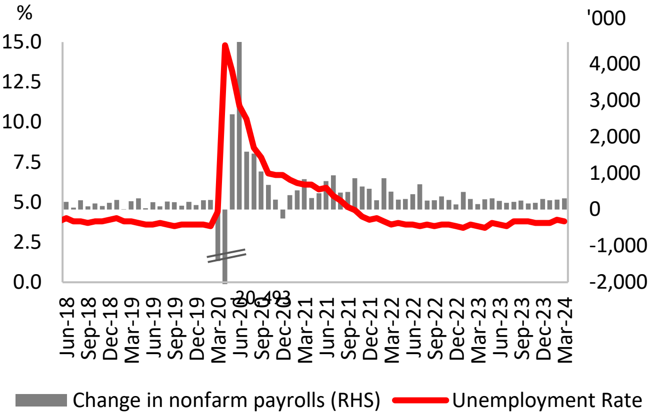
Source: Bloomberg; MIDFR

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



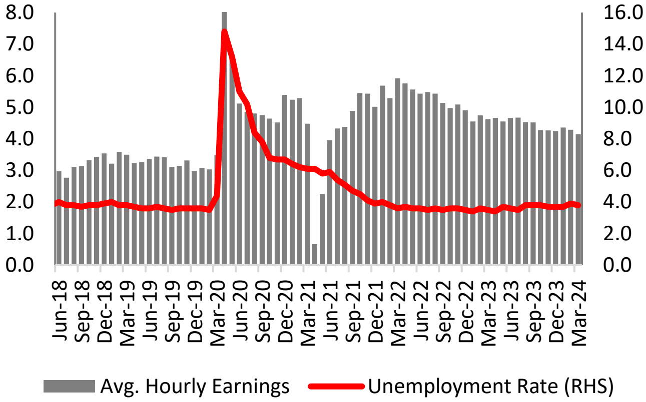
Source: Macrobond, MIDFR

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



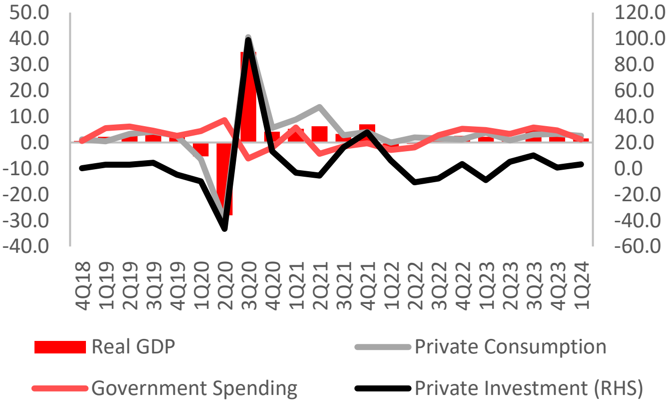
Source: Macrobond, MIDFR

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



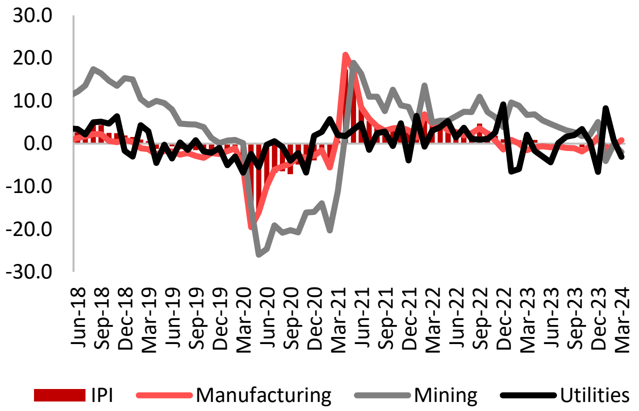
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



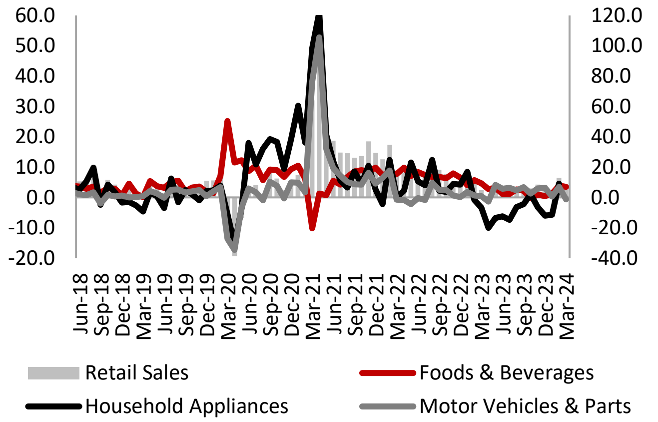
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



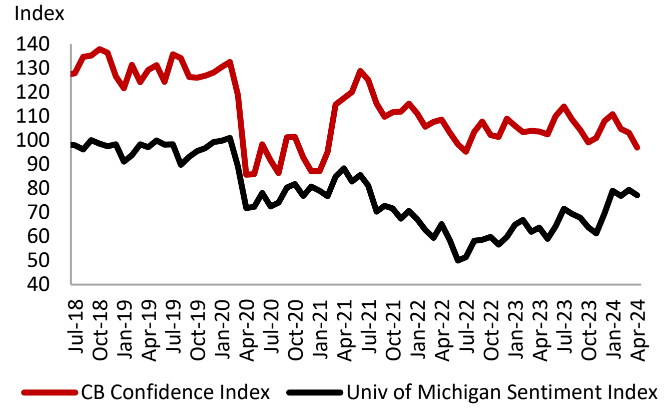
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



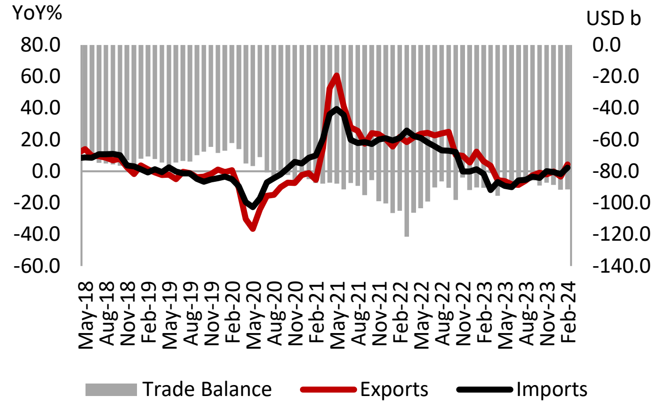
Source: Macrobond, MIDFR

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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