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ECONOMIC REVIEW | July 2022 US FOMC Meeting

Another Large Rate Hike by the Fed, Raising the Fed Funds Rate by 75bps

- *Another aggressive tightening. After the July 2022 FOMC Meeting, the Fed's FOMC announced another large rate hike, raising the fed funds rate by 75 bps to 2.25–2.50%. Although there is concern about economic recession, the back-to-back 75bps hike is in line with market's expectations as the latest data shows inflation remained at highest level in decades.*
- *Inflation is still the key concern. Containing the high inflation in the US remains the main goal for the Fed on the back of still robust economy and job market conditions. Based on the FOMC Statement, inflation in the US remains elevated due to post-pandemic supply-demand imbalance, rise in food and energy prices, and broader price pressures.*
- *Fed funds rate to be raised to above 3% by end-2022. With signs that the economy and the labour market starting to adjust to the policy tightening, we foresee more rate hikes by the Fed at the upcoming FOMC meetings later this year. The Fed may increase the fed funds rate by 50bps at the Sep-22 and eventually begin to slow down the pace of its policy tightening. In general, the fed fund rate will be raised to more neutral levels.*

Another aggressive tightening. After the July 2022 FOMC Meeting, the Fed's FOMC announced another large rate hike, raising the fed funds rate by 75 bps to 2.25–2.50%. Although there is concern about economic recession, the back-to-back 75bps hike is in line with market's expectations as the latest data shows inflation remained at highest level in decades. While the US economy is in a stronger position, the stubbornly high inflation does not support for the Fed to keep interest rates at low levels. As part of its monetary policy adjustment, the Fed will continue with its balance sheet reduction strategy. As announced in May-22, the Fed is reducing its holdings of Treasury and mortgage-backed securities by USD47.5b per month starting from Jun-22, and after 3 months the amount of monthly reduction will be doubled to USD95b from Sep-22. As of third week of Jul-22, the size of Fed's total assets stood at USD8.899 trillion, or USD66.3b lower than the highest level recorded in Apr-22.

Inflation is still the key concern. Containing the high inflation in the US remains the main goal for the Fed on the back of still robust economy and job market conditions. Based on the FOMC Statement, inflation in the US remains elevated due to post-pandemic supply-demand imbalance, rise in food and energy prices, and broader price pressures. Latest data shows headline CPI inflation in the US accelerated to +9.1%yoy in Jun-22, still the highest in 4 decades. Core CPI inflation, on the other hand, eased further to +5.9%yoy, the slowest in 6 months. While latest available data indicates core PCE inflation, the key inflation measure for the Fed, moderated to +4.7%yoy in May-22, the level of demand pressures remains strong and the Fed will likely hike further to bring it closer to the Fed's longer-term target. According to Chair Powell, while the Fed focuses more on core inflation to measure the actual inflation impact to Americans, he highlighted that the Fed also looks at anchoring consumers' inflation expectation. Changing the demand is part of the equation to cool inflation, while it is difficult for the Fed

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to influence the supply condition, particularly in the commodity markets. Once again, the FOMC highlighted the war in Ukraine adds to the inflationary pressures globally.

Front loading the hike for now. The Fed Chair explained that the Fed will eventually consider to slow and adjust the pace of tightening. For now, the Fed is 'front loading' the policy tightening with another aggressive hike at the Jul-22 meeting given its continued focus to bring down the high inflation towards Fed's 2% target. With inflation remaining high, it is affecting the consumers mainly the low-income group who suffer the most. However, Chair Powell expects the Fed will likely discuss changing and possibly decide to slow down the tightening at the upcoming meeting in Sep-22.

No change to the growth projection. The July FOMC concluded without updating the FOMC's growth projection. While the Fed more or less keeps its Jun-22 projection, the Fed Chair indicated the forecast will be updated at the Sep-22 meeting. Reading from the FOMC Statement, the committee sees softening of spending and production activities in the recent period. The Fed Chair indicated that the economy is in a stronger situation, thus the Fed will increase interest rates to a more neutral level. Asked about the possible negative GDP growth in 2QCY22 which would indicate the US entering into recession, the Fed Chair indicated the Fed will not give specific attention to the GDP data. He concluded the US economy is currently not in a recession particularly because of the strong labour market. While the Fed will continue to analyse a wide range of economic data, the Fed will keep its focus on pursuing an economic condition which promotes maximum employment and price stability in a long run.

Job market remained in tight condition, despite signs of change. According to the Fed Chair, the US labour market remained in a very strong situation. Looking at the latest data, despite signs of adjustment in the job market wit, US job market remained in tight condition. More jobs were added in the US economy, with the non-farm payrolls rising by 372K in Jun-22 (May-22: 384K). Amid strong demand for labour, US jobless rate remained unchanged at pandemic-low of 3.6% since Mar-22. The Fed Chair sees the current job market situation is not consistent with the low level of interest rate. Although there are signs of adjustment in labour demand, the Fed Chair believes the currently strong labour market condition supports for further tightening by the Fed.

Fed funds rate to be raised to above 3% by end-2022. With signs that the economy and the labour market starting to adjust to the policy tightening, we foresee more rate hikes by the Fed at the upcoming FOMC meetings later this year. The Fed may increase the fed funds rate by 50bps at the Sep-22 and eventually begin to slow down the pace of its policy tightening. In general, the fed fund rate will be raised to more neutral levels, which will reach 3.4% by end-2022 based on the FOMC projection in Jun-22. While this will depend on the change in inflation situation, inflationary pressures could lessen in the coming months given the recent correction in global commodity prices. Nevertheless, with the US labour market still in strong and tight condition, we expect aggregate demand to slow and also help to ease upward pressure on prices. Although there is concern about

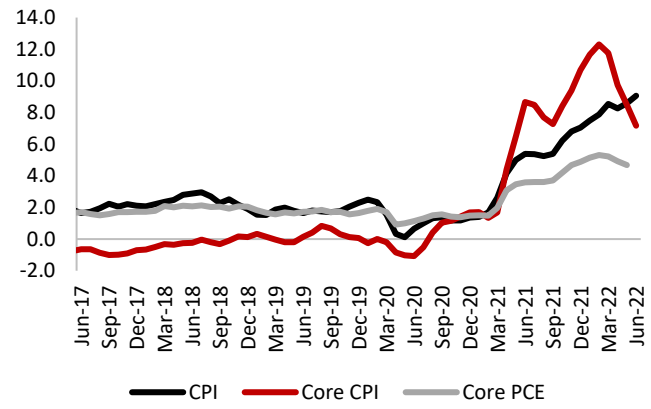
recession, we expect the US economy to experience a soft landing. In other words, the US will be able to maintain positive growth this year despite the aggressive policy tightening by the Fed.

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

	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22
Malaysia	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.00	2.25
Indonesia	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Philippines	2.00	2.00	2.00	2.00	2.00	2.00	2.25	2.50	3.25
Thailand	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Vietnam	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
South Korea	1.00	1.00	1.25	1.25	1.25	1.50	1.75	1.75	2.25
India	4.00	4.00	4.00	4.00	4.00	4.00	4.40	4.90	4.90
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	0.10	0.25	0.25	0.50	0.75	0.75	1.00	1.25	1.25
Euro area	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.50
US	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.00-0.25	0.75-1.00	1.50-1.75	2.25-2.50

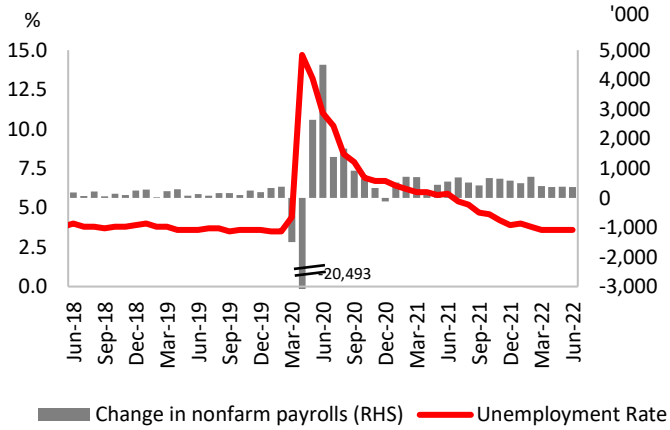
Source: CEIC; MIDFR

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



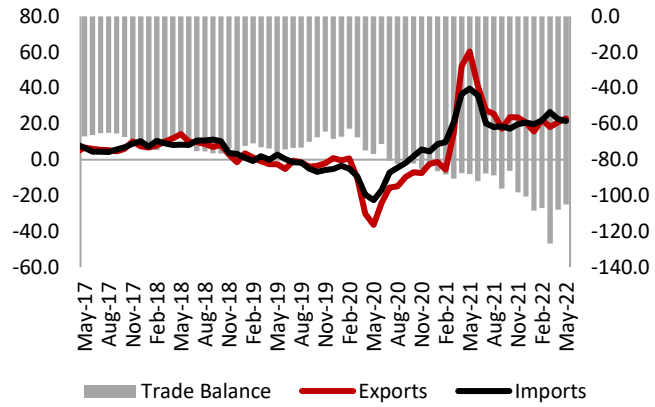
Source: Macrobond, MIDFR

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



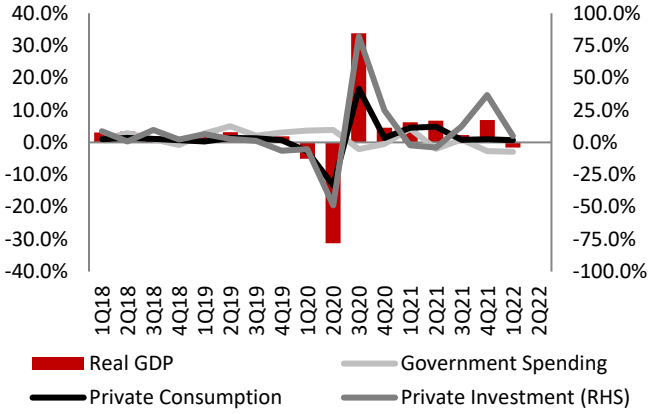
Source: Macrobond, MIDFR

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



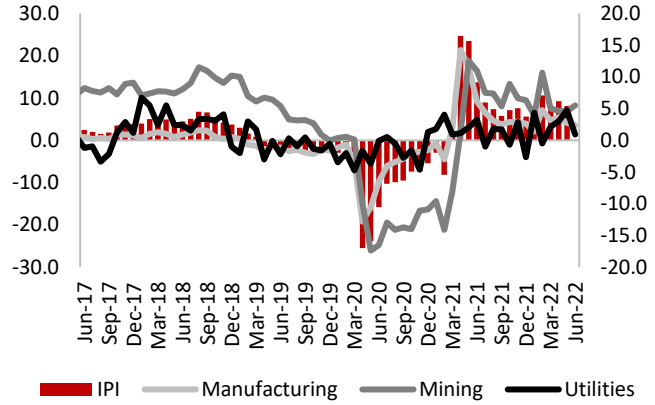
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



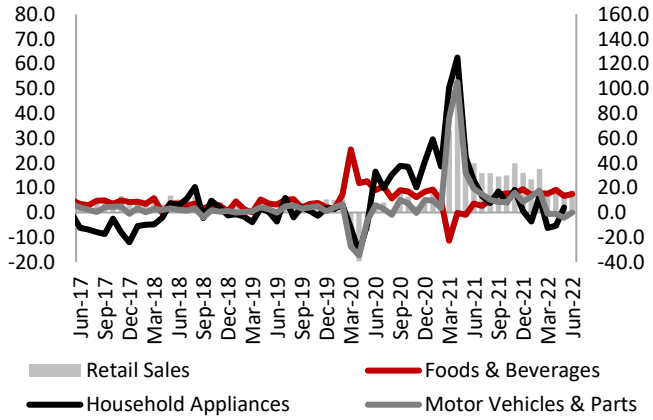
Source: CEIC, MIDFR

Chart 5: US IPI Performances (YoY%)



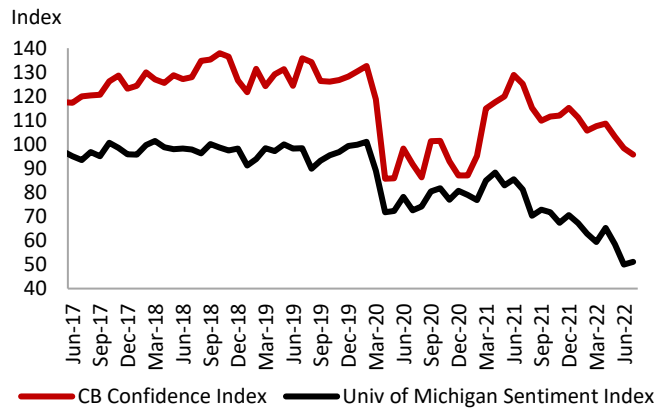
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



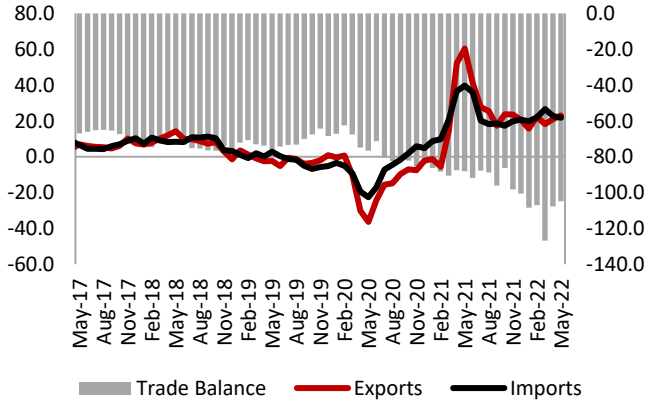
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

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



Source: Macrobond, MIDFR

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