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ECONOMIC REVIEW | September 2022 US FOMC Meeting

Fed Hiked Again by 75bps and Remained Committed to Bring Down High Inflation

- *Fed tightened again by 75bps. At the September 2022 FOMC Meeting, the US Fed's FOMC decided to hike the Fed funds rate to 3.00–3.25%, the third back-to-back 75bps increase since Jun-22. The decision was broadly in line with market consensus in reaction to the inflation remaining at high level in Aug-22.*
- *FOMC's revised down US growth forecast. The FOMC also downgraded its growth forecast for the US economy. A stark change in the real GDP forecast is the mainly highlight as the FOMC's central projection now anticipates the US economy to only grow by +0.2% in 2022 (Jun-22 forecast: +1.7%). This can be linked to the higher Fed funds rate projection which will be raised to 4.4% in 2022.*
- *Fed to raise Fed funds rate above 4% by year-end. The strong labour market and continued growth in personal consumption support for further rate hike amid high inflation in the US. Taking into account the elevated inflation and the strength in the US economy, we expect further rate hikes by the Fed which will push the Fed funds rate above 4% by end of this year.*

Fed tightened again by 75bps. At the September 2022 FOMC Meeting, the US Fed's FOMC decided to hike the Fed funds rate to 3.00–3.25%, the third back-to-back 75bps increase since Jun-22. The decision was broadly in line with market expectations in reaction to the inflation remaining at high level in Aug-22 and still strong labour market condition. In addition to the rate hike, the Fed will proceed with its plan to reduce its balance sheet, where the amount of reduction will be be doubled to USD95b per month starting from this month. As of mid-September 2022, Fed already trimmed down its balance sheet to USD8.833 trillion, total reduction of USD132.7b from the highest level in mid-April 2022. Consequently, following the monetary policy tightening, real money as measured by M2 declined by -3%yoy in Aug-22, registering annual fall for the fourth month in a row.

FOMC's revised down US growth forecast. The FOMC also downgraded its growth forecast for the US economy. A stark change in the real GDP forecast is the main highlight as the FOMC's central projection now anticipates the US economy to only grow by +0.2% in 2022 (Jun-22 forecast: +1.7%). This can be linked to the higher Fed funds rate projection, upgraded to 4.4% for 2022 (Jun-22 forecast: 3.4%) as the Fed needs to be more aggressive to address high inflation. The upward revision to unemployment and inflation rates, however, is less significant. Jobless rate is expected to reach 3.8% this year (previous forecast: 3.7%), and headline and core PCE inflation rates raised to 5.4% (from 5.2%) and 4.5% (from 4.3%), respectively. For 2023, Fed funds rate is expected to be raised to 4.6%, with US GDP growth to strengthen to 1.2% (lower than 1.7% predicted previously). While PCE inflation will be moving towards 3% next year, FOMC members project job market to soften that will push US unemployment rate higher to 4.4% (Jun-22 forecast: 3.9%). So far, the Fed concluded no clear sign that the job market is cooling off; therefore, this supports for further policy tightening.

US job market still strong. According to the FOMC statement, job growth in the US remained robust. Looking at the latest data, conditions in the US job market remained tight. Nonfarm payrolls increased further by +315K in Aug-22 (Jul-22: +526K), with monthly average increase of +381K between Mar-22 to Aug-22. Cumulatively, 22.2

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jobs were been added from May-20 to Aug-22, already exceeded -20.5m jobs lost in Apr-20 alone due to the pandemic. Due to strong labour demand, US jobless rate dropped to pandemic-low of 3.5% in Jul-22. The data in Aug-22 suggests adjustment in the job market will gradually take place as the jobless rate rose to 3.7%. This can be due to higher unemployment count or increase in participation rate as more Americans joined the job market.

Lower chance for soft landing. In response to the question about soft landing of the US economy, Chair Powell responded that the possibility (of soft landing) has diminished because the Fed funds rate would be adjusted higher than previously anticipated. He also stated that the current slowdown and correction are necessary to restore balance in the US housing market. Similarly, the cost to bring down inflation will also cause demand to soften, Americans to lose their jobs and therefore push jobless rate higher. The currently strong labour market condition is deemed inconsistent with the Fed's long-term price stability.

Bring down inflation remains the Fed's top priority Not denying the possible risk of US economy heading into recession, Jerome Powell also stressed that inflation remains the Fed's main focus "until the job is done". The Fed hoped to see recent commodity price correction and improvement in the supply condition would ease inflationary pressures, but the existing level of gasoline prices are still higher than last year. In addition, the Fed Chair also highlighted that the shelter inflation, for example, will likely take some time before it goes down. This in a way indicates the decline in price pressures is not happening as fast as previously anticipated by the Fed.

Ensuring "restrictive" level of interest rate to battle high inflation. The Fed Chair indicated that the current level of Fed funds rate is yet to be "restrictive", and therefore unable to pose "meaningful downward pressure" on inflation. Despite the cumulative 300bps hikes so far this year, Chair Powell believes the current level of borrowing cost is only at the lower end of the "restrictive" range. So, he expects the Fed will need to act quickly to increase fed funds rate closer to the restrictive level.

No details on when Fed would slow policy tightening or even pause. During the press conference, Fed Chair did not offer any clear guidance on when the Fed will decide to change the pace of policy tightening. He only reiterated that the current inflation remained high and above the Fed's 2%-target. Until there is compelling evidence that US inflation is going down, the Fed will continue to tighten its monetary policy. While the 4.4% year-end target for the Fed funds rate reflects the FOMC's latest assumption, the projection indicates cumulative 125bps hikes at the next two meetings in Nov-22 and Dec-22. Jerome Powell also added that a large group of Fed policymakers also anticipate additional 100bps hikes, instead of 125bps. While this alludes to possible 50bps or 75bps hike at the next meeting, the Fed stated that the pace of tightening will be determined by incoming data, evolving outlook and taking into account broad range of information such as the public health, job market, inflation and inflation expectations as well as developments in the financial and international markets.

Latest core CPI inflation signals broader rise in price pressures. The FOMC statement again indicated that there was broader price pressures, although the source of inflation came from both supply and demand imbalance. For instance, the war in Ukraine had caused commodity prices to increase previously. As of Aug-22, US headline CPI inflation eased to +8.3%yoy (Jul-22: +8.5%yoy) mainly due the recent declines in gasoline prices. However, the core CPI inflation rose to +6.3%yoy in Aug-22 (Jul-22: +5.9%yoy), the fastest in 5 months.

Based on core PCE prices which is the Fed's preferred measurement of inflation, the rate of inflation remained at high levels. This, according to Fed Chair, is backed by the trailing figures for core PCE inflation which had been hovering around 4.5%yoy and 4.8%yoy in the past 3 months. He emphasized that the high core PCE inflation alone is sufficient proof that the Fed's mission is far from complete.

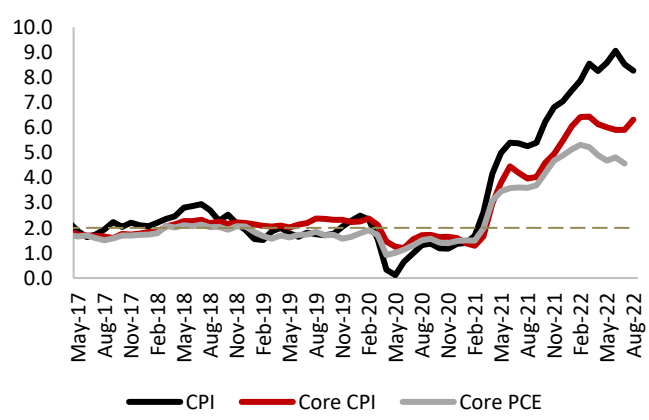
Fed to raise fed funds rate above 4% by year-end. The strong labour market, high wage growth and rising personal consumption support for further rate hike by the Fed. Taking into account the elevated inflation and the strength in the US economy, we expect further rate hikes by the Fed which will push the fed funds rate above 4% (compared to 3% previously) by end of this year. Reading from the message from the Fed Chair, the Fed will prioritize tackling high inflation even if it costs the US economy to slow sharply. In other words, the Fed wants to see significant changes now to bring down inflation in the longer run. As we head towards year-end, further easing of US inflation will likely result in smaller rate hikes (either 25bps or 50bps). The lag effect of monetary policy changes to real economy suggests the US economy could slow going into next year, and softer demand will help to bring down inflation, apart from improving supply. But, if inflation remains stickily high and not easing as fast as projected, the Fed may be forced to raise Fed funds rate to even higher levels.

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

	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
Malaysia	1.75	1.75	1.75	1.75	2.00	2.00	2.25	2.25	2.50
Indonesia	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75	3.75
Philippines	2.00	2.00	2.00	2.00	2.25	2.50	3.25	3.75	3.75
Thailand	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75
Vietnam	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
South Korea	1.25	1.25	1.25	1.50	1.75	1.75	2.25	2.50	2.50
India	4.00	4.00	4.00	4.00	4.40	4.90	4.90	5.40	5.40
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	0.25	0.50	0.75	0.75	1.00	1.25	1.25	1.75	1.75
Euro area	0.00	0.00	0.00	0.00	0.00	0.00	0.50	0.50	1.25
US	0.00-0.25	0.00-0.25	0.25-0.50	0.25-0.50	0.75-1.00	1.50-1.75	2.25-2.50	2.25-2.50	3.00-3.25

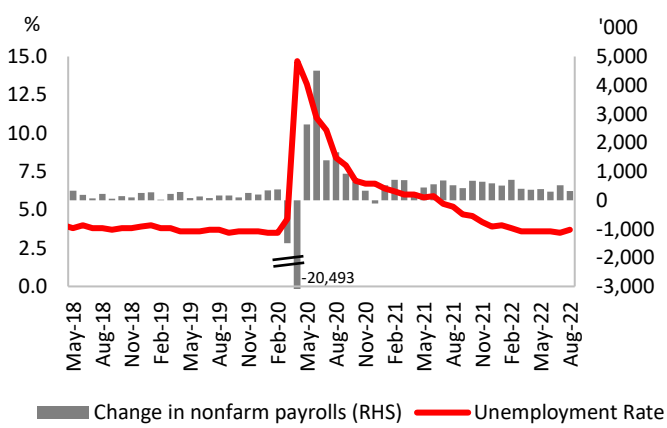
Source: CEIC; MIDFR

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



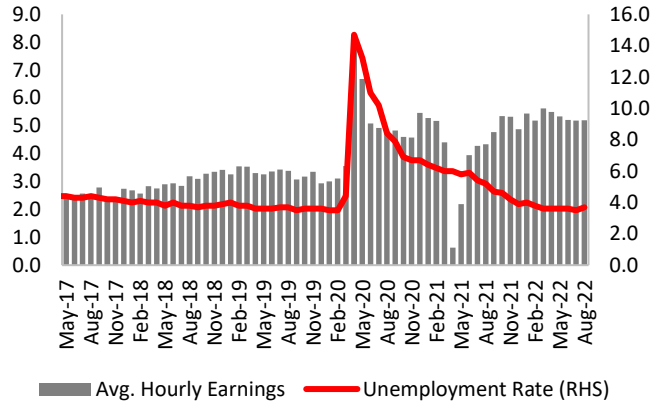
Source: Macrobond, MIDFR

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



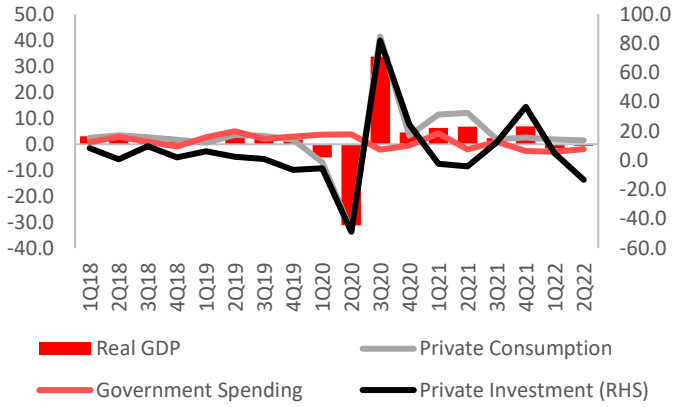
Source: Macrobond, MIDFR

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



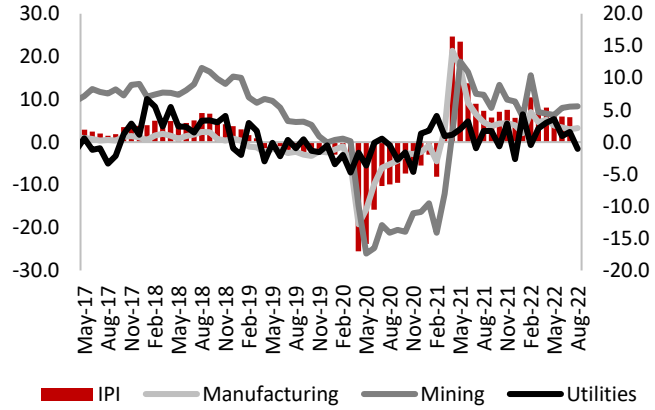
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



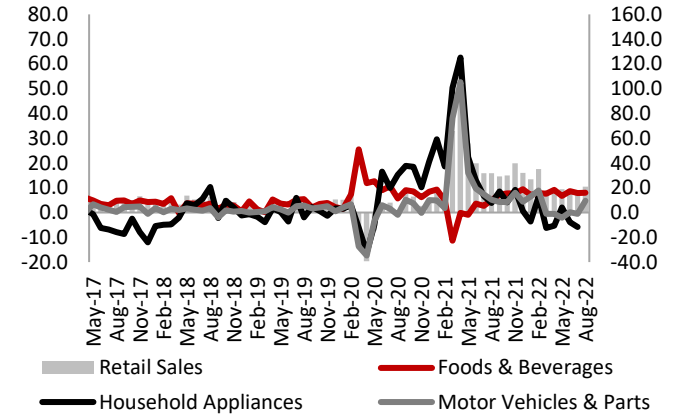
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



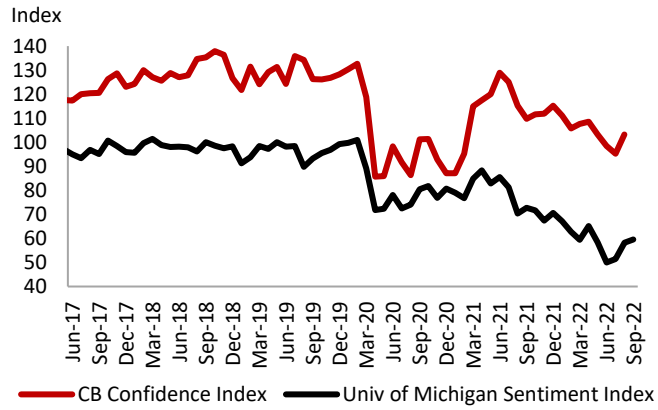
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



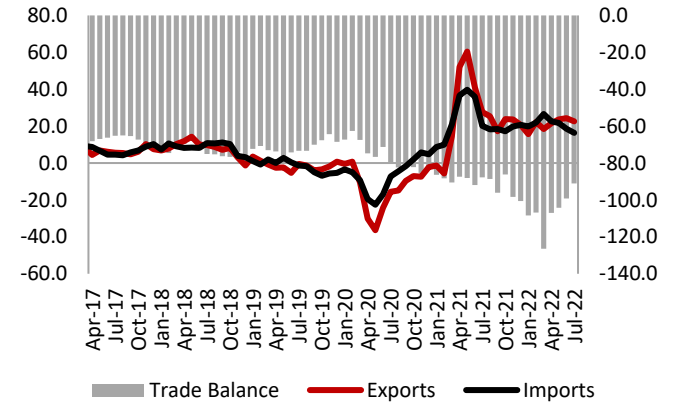
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

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



Source: Macrobond, MIDFR

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