02 February 2023

ECONOMIC REVIEW | February 2022 US FOMC Meeting

FOMC Hikes FFR by 25bps as Widely Predicted and Expects No Rate Cuts this Year

- *Raise by 25bps and still looking at more hikes. The Fed's FOMC decided after its first policy meeting this year to hike fed funds rate (FFR) by 25bps to 4.50–4.75%, and reiterates its commitment to continue raising rates as inflation remains above the Fed's long-run 2% target.*
- *Fed does not expect rate cuts this year. Given the Fed's existing forecast and growth outlook, Powell indicated the Fed remains committed to bring down inflation and still looking at raising rates to ensure restrictive stance. Powell said rate cuts will not be appropriate this year assuming softening growth and inflation goes according to Fed's forecast.*
- *We expect FFR to be raised to 5.00% this year. As inflation remained elevated and Fed remains committed to push its policy rate to be more restrictive, we expect the fed funds rate to be raised further towards 5.00% at the next FOMC meeting. Reading from the Fed's forecast, inflation remains the Fed's main focus which will be contained and move towards 2% target at the expense of economic growth and also require adjustment in the labour market.*

Raise by 25bps and still looking at more hikes. The Fed's FOMC decided after its first policy meeting this year to hike fed funds rate (FFR) by 25bps to 4.50–4.75%, and reiterates its commitment to continue raising rates as inflation remains above the Fed's long-run 2% target. While the Fed will continue to shrink its balance sheet, the smaller rate hike was deemed appropriate as recent data shows inflation slowing down, but the Fed Chair Jerome Powell described the current disinflationary trend is still at early stage. Following the latest decision, Fed has raised FFR cumulatively by 450bps over the past year, with the size of Fed's balance sheet declining further to USD8.47 trillion i.e. total reduction of USD494.9b from the peak in mid-April 2022.

No change to growth forecast, still expect low growth and no recession. Despite economic data pointing towards slowing growth, with the US GDP growth weakened last year, Chair Powell stressed at the press conference that the FOMC's forecast remains the same and will only be updated at the next meeting in Mar-22. In contrast to market's view, Powell highlighted that the FOMC forecasts the US economy will experience below trend growth, still positive but subdued, and will be able to avert recession because demand will not collapse significantly given the strength in the economy and job market. On another note, the Fed no longer thinks Covid-19 infections pose significant risk to the US economy.

Fed does not expect rate cuts this year. Given the Fed's existing forecast and growth outlook, Powell indicated the Fed remains committed to bring down inflation and still looking at raising rates to ensure restrictive stance; more data is needed before the Fed can declare inflation is on a sustained slowdown. As the Fed aims to forcefully control demand pressures on prices as well as contain inflation expectations, Powell said rate cuts will not be appropriate this year assuming softening growth and inflation goes according to Fed's forecast. Like

before, Chair Powell reiterates the Fed's decision will be data-dependent and therefore will decide accordingly if inflation were to trend lower faster than expected.

Inflation on easing trends... Inflation in the US has been slowing down, with the core PCE price inflation easing to +4.4%yoy in Dec-22, the lowest reading in more than a year. As it remains above the Fed's 2%, this supports for further hike by the Fed and then keep rates at high levels to ensure restrictive interest rates will soften demand pressures on prices. In particular, headline CPI inflation slowed to +6.5%yoy in Dec-22, remaining on easing trend over the past 6 months and marking the slowest rate since Oct-21. The fall in gas prices and slower energi inflation has been the key contributor to slower CPI inflation. We believe inflation will continue to ease as aggregate demand is expected to be constrained by higher borrowing costs and eventual adjustment in labour demand. However, we opine positive wage growth, albeit also eased in recent months, and stickier inflation outlook may push Fed to keep raising rates to higher levels.

...but core services prices ex-housing are still elevated. Chair Powell elaborated that the disinflationary trend needs to be reflected by wider price components. He shared that the goods inflation has started to come off as demand shifted towards services, and charges for housing services will also ease although it will likely increase due to new leases. His main concern is that inflation can be more difficult to predict because existing business cycle is different than before. The Fed previously expected rising inflation to be temporary but later proven to be not transitory. On that note, more data is needed to ensure inflation will continue to ease in coming months. In particular, Powell mentioned that there is no sign of easing for a number of core services prices (excluding housing) which explains why overall inflation remained elevated.

No sign of wage spiral on prices and important to anchor inflation expectations. Fed Chair concurred that there is no spiral of wage pressures on inflation in the US; recent surveys showed inflation expectations have improved, and inflation is anticipated to go down. The Fed is generally pleased with the development, indicating wage spiral has not been embedded in price outlook and inflation expectations have been under control. Nevertheless, elevated inflation remains the key focus which keeps consumer sentiment at low levels because strong labour market and positive wage growth failed to boost confidence to high levels.

Job market remained tight. The robust job market conditions remained the key challenge for the Fed to pivot while hoping to see adjustment in the job market. Thus far, there is not clear indication that unemployment rate in the US will significantly increase as firms are expected to eventually cutting down payrolls to cope with rising borrowing costs and weaker demand outlook. However, job growth remained positive, albeit at relatively slower rate as non-farm payrolls increased by average 247K per month in 4QCY22 (vs. 637K in 4QCY21). While more jobs are still added, unemployment rate dropped to 3.6% in Dec-22, similar to Sep-22 and the lowest since Covid-19 pandemic started. Trend in jobless benefits claims also shows no significant rise in filings, in fact latest weekly claims in Jan-23 fell to 186K which was the lowest since Apr-22. While Fed may be compelled to tighten further, we believe the strength in the job market will ensure US economy to experience soft landing or at least avoid sharp recession as demand condition will be adjusting gradually to previous rate hikes.

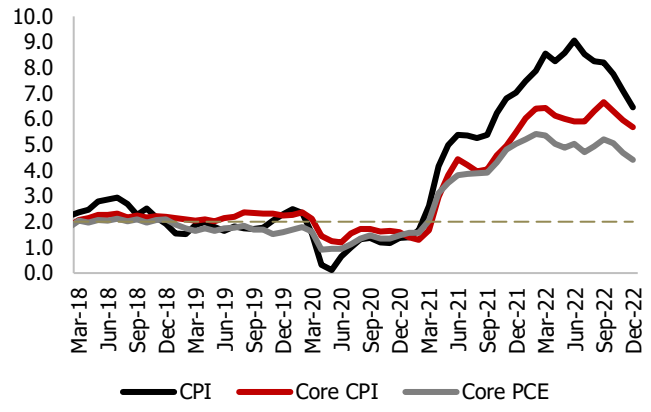
We expect FFR to be raised to 5.00% this year. As inflation remained elevated and Fed remains committed to push its policy rate to be more restrictive, we expect the fed funds rate to be raised further towards 5.00% at the next FOMC meeting. Easing inflation will boost confidence and positive wage growth on the back of tight job market will allow for more hikes to contain overall demand pressures. We forecast the US economy would experience a soft landing driven by consumer spending, which continued to grow in 4QCY22 even after aggressive rate hikes last year. Reading from the Fed's forecast, inflation remains the Fed's main focus which will be contained and move towards 2% target at the expense of economic growth and also require adjustment in the US labour market. If the effect of policy tightening is more significant, i.e. demand would fall sharper later this year, we opine Fed will eventually consider easing its monetary policy to support the economy.

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

	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23
Malaysia	2.00	2.00	2.25	2.25	2.50	2.50	2.75	2.75	2.75
Indonesia	3.50	3.50	3.50	3.75	4.25	4.75	5.25	5.50	5.75
Philippines	2.25	2.50	3.25	3.75	4.25	4.25	5.00	5.50	5.50
Thailand	0.50	0.50	0.50	0.75	1.00	1.00	1.25	1.25	1.50
Vietnam	4.00	4.00	4.00	4.00	5.00	6.00	6.00	6.00	6.00
South Korea	1.75	1.75	2.25	2.50	2.50	3.00	3.25	3.25	3.50
India	4.40	4.90	4.90	5.40	5.90	5.90	5.90	6.25	6.25
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	1.00	1.25	1.25	1.75	2.25	2.25	3.00	3.50	3.50
Euro area	0.00	0.00	0.50	0.50	1.25	2.00	2.00	2.50	2.50
US	0.75-1.00	1.50-1.75	2.25-2.50	2.25-2.50	3.00-3.25	3.00-3.25	3.75-4.00	4.25-4.50	4.50-4.75

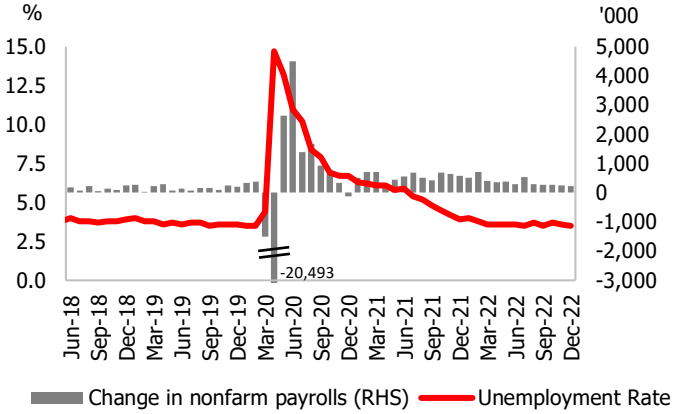
Source: Bloomberg; MIDFR

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



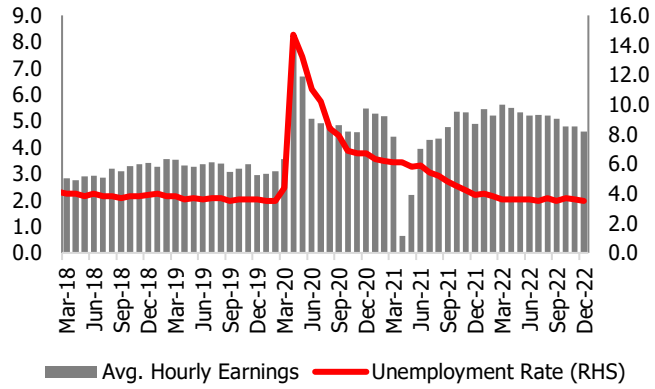
Source: Macrobond, MIDFR

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



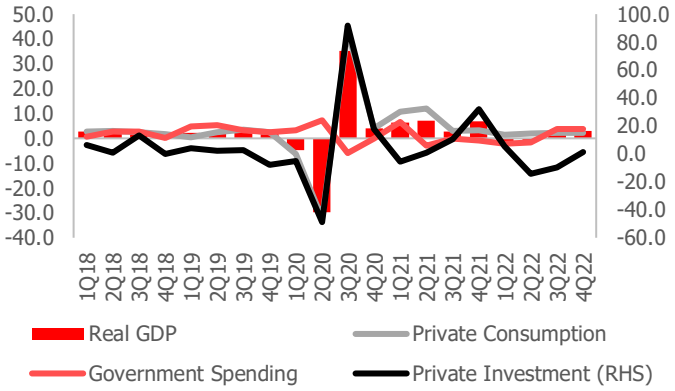
Source: Macrobond, MIDFR

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



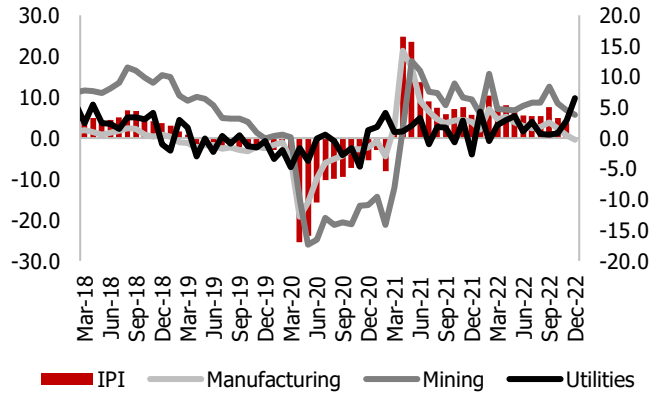
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



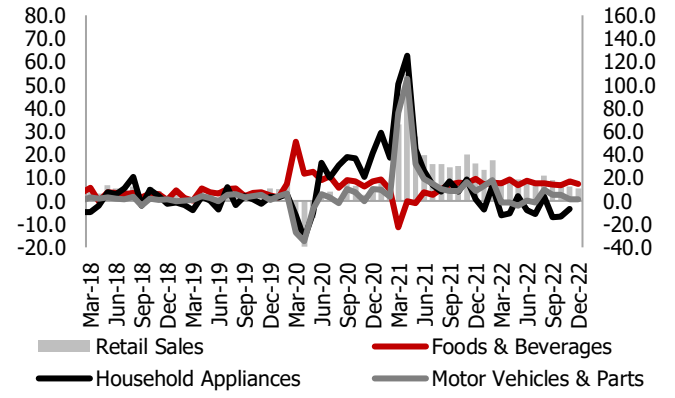
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



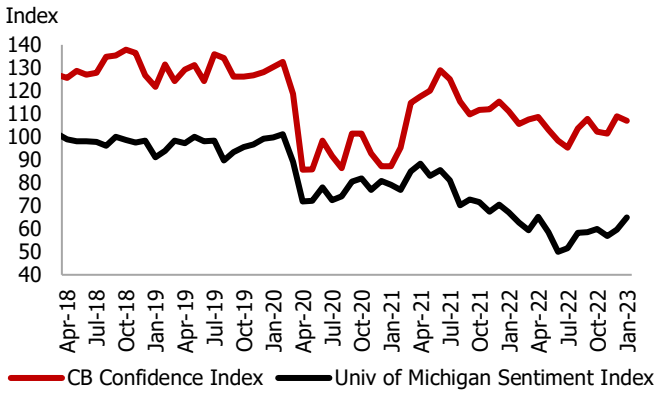
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



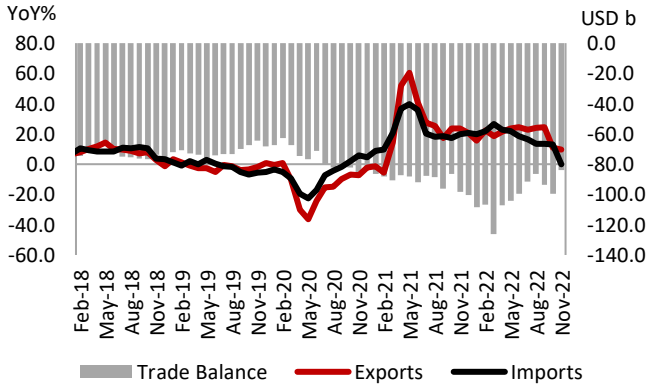
Source: Macrobond, MIDFR

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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