5 May 2023

ECONOMIC REVIEW | May 2023 US FOMC Meeting

Fed Raised FFR Further but Keeping it Open for Possible Pause or More Policy Firming

- *Fed hiked by +25bps as widely anticipated. The Fed's FOMC decided to raise the fed funds rate by +25bps to 5.00-5.25% at the May-23 policy meeting, similar to market forecast as inflation remained well above the Fed's 2%-longer term price stability target.*
- *No change to FOMC forecast. Chair Powell expressed his confidence that the US economy will be able to avoid recession. The US economy will continue to grow on the back of rising consumer spending and the strength in the job market. If the US were to fall into recession, he believes it will only be a mild recession.*
- *Still hawkish despite approaching the end of tightening cycle. As inflation remained above the Fed's 2% target, we expect the Fed will keep its focus to bring down inflation. With the fed funds rate already at the FOMC's forecasted terminal rate of 5.1%, the current setting seems to be in the restrictive territory. But, if inflation remained sticky and the economy continued to show resilience, the Fed may consider raising its policy rate to a more restrictive level, against market expectations for a pause.*

Fed hiked by +25bps as widely anticipated. The Fed's FOMC decided to raise the fed funds rate by +25bps to 5.00-5.25% at the May-23 policy meeting, the level last seen in 2006 and bringing the cumulative hikes to +500bps since Mar-22. The latest hike in May-23 was broadly similar to market forecast which factored in another 25bps increase as inflation remained well above the Fed's 2%-longer term price stability target. While the FOMC removed ensuring its policy stance to be "sufficiently restrictive" from its post-meeting statement, the Fed reiterated more 'policy firming' is deemed necessary to bring inflation down to 2%. Changing the fed funds rate will be based on the Fed's assessment on recent developments in the economy and financial market, and impacts of previous rate hikes as well as the lag effect to the economy and inflation.

Not looking at rate cuts latter this year… Against market expectations for rate cuts at the latter part of the year, Chair Powell indicated that the FOMC did not decide on the possible pause at the next meetings. He stressed that the Fed's approach to be data-dependent when it comes to its future policy changes. As inflation remained high and the economy continued to grow, the Fed remained committed and hawkish in its fight to push inflation lower. We noticed that the market somehow perceived the Fed sounding dovishly hawkish, signaling for possible pause from further tightening.

No change to FOMC forecast. Chair Powell expressed his confidence that the US economy will be able to avoid recession. While there is no change to the FOMC projection, the positive growth forecast for 2023 suggests the economy will continue to grow on the back of rising consumer spending and the strength in the job market. Despite the Fed staff's projection of a possible mild recession when analyzing the effect of the recent banking turmoil and tighter credit conditions, Chair Powell indicated that it was not the consensus view among the FOMC members. In other words, even if the US were to fall into recession, the Fed Chair believes it will only be mild given the resilience in the economy.

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No major concern about the banking system, credit tightening will affect the economy. On the health of the US banks, the Fed kept its positive and sound assessment of the US banking industry. Nevertheless, the Fed is pushing for tighter and more stringent supervision for selected banks in the wake of recent turmoil. Although the risk of a banking sector collapse is low and the prompt actions by the US regulators limited the contagion effect, Chair Powell indicated that there will still be downward drag to the economy from the credit tightening.

Inflation down but sticky… Inflation in the US looks stubbornly remained above the Fed's 2% target although the recent trend shows continued deceleration. The headline CPI inflation eased to +5%yoy in Mar-23, the lowest since May-21, with slower rise in food and energy prices. Meanwhile, core CPI inflation was sticky, rising slightly to +5.6%yoy (Feb-23: +5.5%yoy), attributable to the higher cost of rent and shelter. Looking at the Fed's favoured measure of inflation, the core PCE price inflation eased slightly to +4.6%yoy in Mar-23, showing no clear sign of disinflating further as the reading has been hovering around +4.6%yoy and +4.7%yoy Dec-22 after decelerating from the recent peak of +5.2%yoy in Sep-22. The stickiness is more or less as predicted by the Fed because Chair Powell mentioned after the previous FOMC meetings that the rise in housing-related costs will keep inflation in 1HCY23. With no clear conviction that inflation moderate further, this explains the reluctance to clearly signal for a pause or a switch to dovish stance.

…and wage growth not the main driver for inflation. The Fed Chair clarified that the rise in wages was not the "principal driver" of rising prices. The message somewhat differs from his statement in the previous post-FOMC press conferences which he mentioned about the wage-inflation spiral. We still believe some cooling in the price pressures can be linked to easing wage pressures as average hourly earnings rose by +4.5%yoy in Jan-Feb 2023, slower than +5.5%yoy in the same period a year ago. On a longer perspective, Chair Powell alluded that the recent +5%yoy growth in wages was on the high side, which he mentioned about the rate of wage increases has to be more moderate at around +3% in order to be "consistent with inflation over time."

Labour market remained tight. The Fed still concluded that the labour market condition remained tight because demand for workers exceeded labour supply and albeit the recent finding indicated less number of US companies complained about filling in vacancies. Despite the strength in the job market, job creation has slowed to +236K in Mar-23, the slowest monthly rise in the nonfarm payrolls in more than 2 years. The increase in hirings were recorded mainly in the services sectors such as leisure & hospitality, food services & drinking places, government, professional & business services, and health care. The jobless rate, on the other hand, fell further to 3.5% in Mar-23, still around pandemic lows. There is no indication that the job market is worsening after the aggressive rate hikes last year because weekly claims for unemployment benefits remained at low levels.

Still hawkish despite approaching the end of tightening cycle. As inflation remained above the Fed's 2% target, we expect the Fed will keep its focus to bring down inflation. With the fed funds rate already at the FOMC's forecasted terminal rate of 5.1%, the current setting seems to be in the restrictive territory i.e. the real rate turning positive, considering the latest inflation readings moving below the policy rate. Credit tightening by

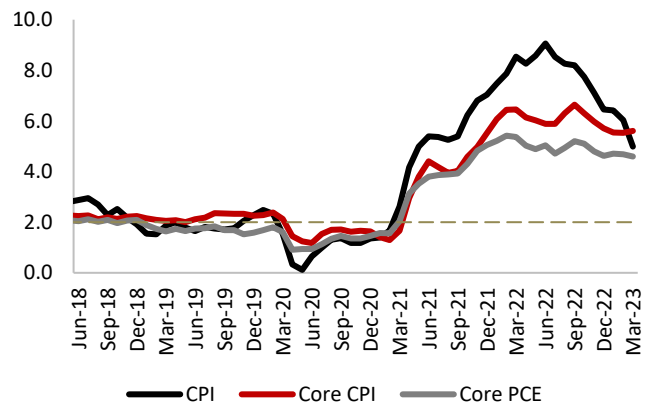
the banks from the recent turmoil also supports the Fed to pause, reducing the need for further rate hikes. Nevertheless, we opine the Fed will keep its hawkish stance as the central bank reiterated the intention to engineer below-trend economic growth and adjustment in the labour market condition that will push inflation down towards its longer-term target. If new data suggests inflation remaining sticky (i.e., not moving down as anticipated) and the economy showing more resilience to cope with rising costs of borrowing, we do not rule out the Fed will consider raising its policy rate to a more restrictive level, instead of the pause (or the end of tightening cycle) as predicted by market.

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

	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23
Malaysia	2.50	2.50	2.75	2.75	2.75	2.75	2.75	2.75	3.00
Indonesia	4.25	4.75	5.25	5.50	5.75	5.75	5.75	5.75	5.75
Philippines	4.25	4.25	5.00	5.50	5.50	6.00	6.25	6.25	6.25
Thailand	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75
Vietnam	5.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
South Korea	2.50	3.00	3.25	3.25	3.50	3.50	3.50	3.50	3.50
India	5.90	5.90	5.90	6.25	6.25	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	2.25	2.25	3.00	3.50	3.50	4.00	4.25	4.25	4.25
Euro area	1.25	2.00	2.00	2.50	2.50	3.00	3.50	3.50	3.75
US	3.00-3.25	3.00-3.25	3.75-4.00	4.25-4.50	4.25-4.50	4.50-4.75	4.75-5.00	4.75-5.00	5.00-5.25

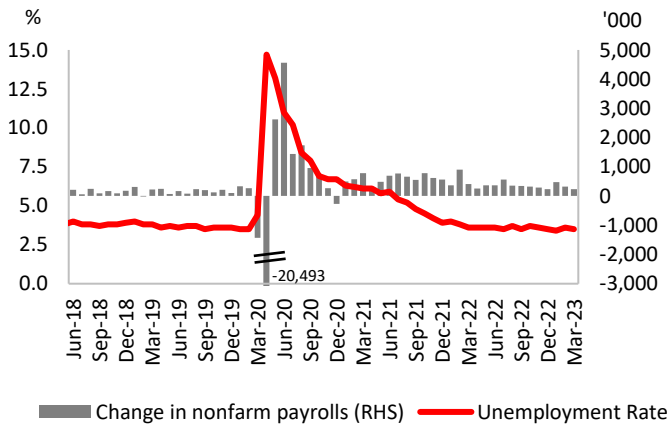
Source: Bloomberg; MIDFR

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



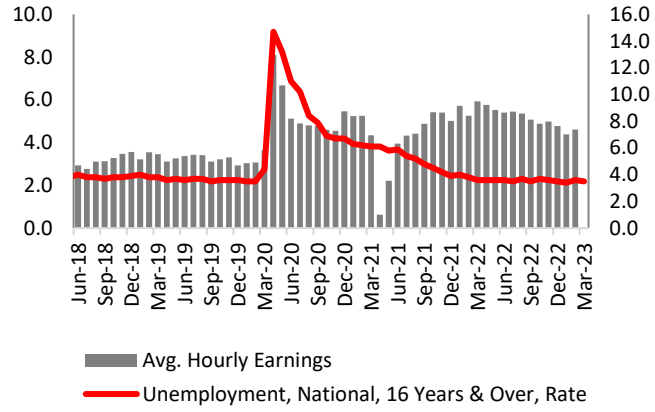
Source: Macrobond, MIDFR

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



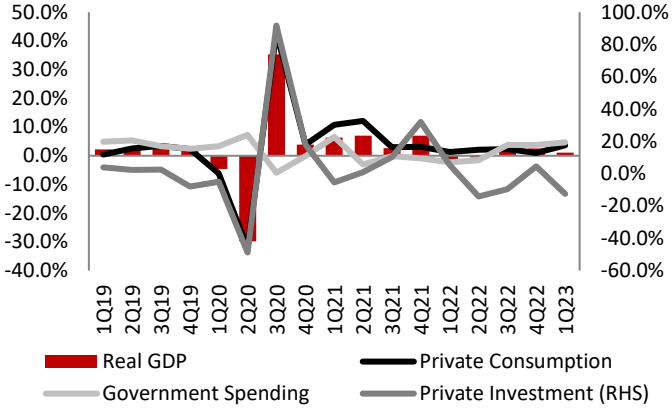
Source: Macrobond, MIDFR

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



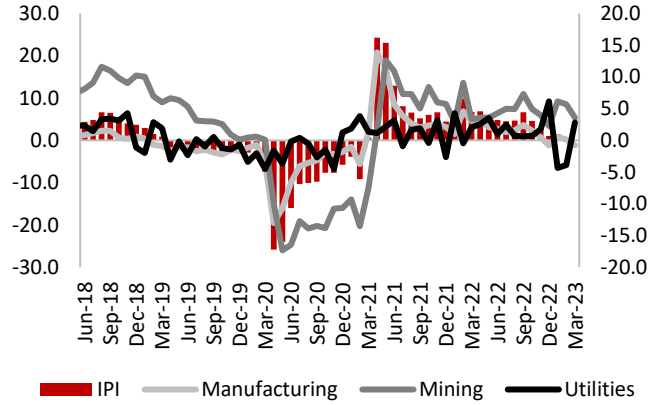
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



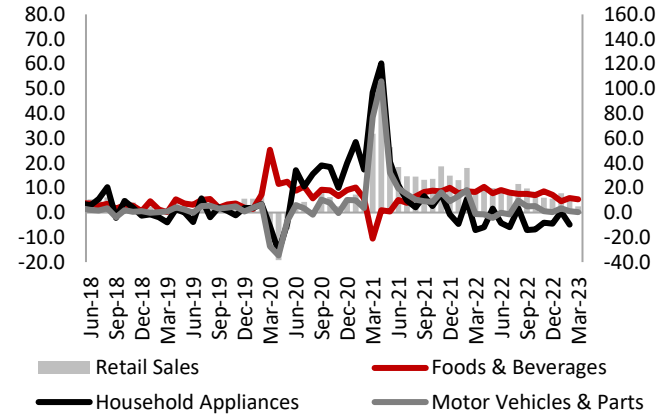
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



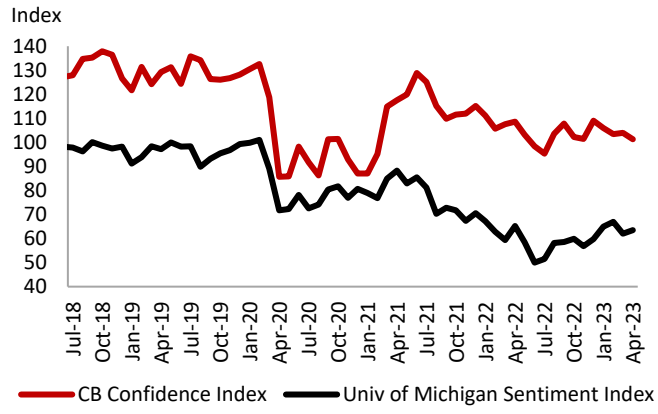
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



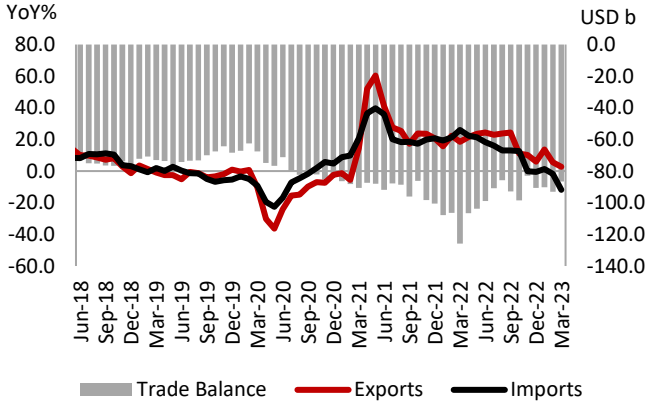
Source: Macrobond, MIDFR

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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