21 March 2024

ECONOMIC REVIEW | March 2024 US FOMC Meeting

Fed Maintains Fed Funds Rate at High Level, Still Predicting Rate Cuts Later this Year

- *No change to the policy rate. The Fed's FOMC decided to maintain the existing target of fed funds rate at 5.25-5.50% after the Mar-24 policy meeting. The move was expected as the Fed adopts a cautious approach before considering rate cuts.*
- *Upward revision to projection for GDP and core PCE inflation. The FOMC has a brighter view of the US economic growth and inflation, revising the 2024 GDP growth to +2.1% (Dec-23 forecast: +1.4%). The FOMC members also predicted the core PCE inflation would ease to +2.6% (Dec-23 forecast: +2.4%).*
- *Fed prefers not to cut rates too soon. Re-acceleration in inflation will require the Fed to adopt a more restrictive policy (i.e. higher interest rates) to bring inflation down to its 2% target. At the same time, keeping the high borrowing costs for too long could cause a significant slowdown in the US economy.*
- *We expect the Fed to cut rates in the latter half of this year. As the core inflation moderates further, we foresee the Fed will likely cut its policy interest rate in the latter half of 2024. However, the continued resilience in the US economy and prolonged period of elevated inflation could delay the Fed's decision to cut interest rates.*

No change to the policy rate. The Fed's FOMC decided to maintain the existing target of fed funds rate (FFR) at 5.25-5.50% after the Mar-24 policy meeting. The move was similar to market expectations, as the Fed has been signalling its cautious approach to future policy adjustment, waiting for more convincing evidence that the US inflation is moving sustainably lower before considering for rate cuts. Aside from keeping FFR unchanged, the Fed will continue to reduce its holdings of financial securities (i.e. Treasury and mortgage-backed securities) as part of its quantitative tightening; since the peak in Apr-22, the Fed's total holding of securities has dropped nearly USD1.5t. This suggests the Fed continues to tighten its monetary policy as the latest inflation reading remained elevated albeit having eased from the multi-year highs as a result of the Fed's aggressive rate hikes.

Upward revision to projection for GDP and core PCE inflation… The latest projection shows that the FOMC has a brighter view of the US economic growth and inflation. The median for US GDP growth was significantly upgraded to +2.1% (Dec-23 forecast: +1.4%). This suggests despite the policy tightening by the Fed, the US economy continued to show resilience and the economy will likely grow at its normal pace this year. Even for 2025, the GDP growth projection was revised higher to median +2.0% (Dec-23 forecast: +1.8%). Although the forecast for headline PCE inflation was kept at +2.4%, the FOMC members predicted the core PCE inflation to be at +2.6% this year (Dec-23 forecast: +2.4%). This somewhat indicates the Fed's concerns that inflation may not decelerate as fast as anticipated given the recent higher-than-expected inflation reading. There was no change to the projection in 2025 as core PCE inflation is expected to ease further to +2.2%.

…but still expecting rate cuts this year. Despite the upward revision to growth and inflation, the FOMC members still predicted the fed funds rate would be slashed to median 4.6% this year and to be cut further to 3.9% next year (Dec-23 forecast: 3.6%). This suggests the FOMC still projected there will be policy easing that

will reduce the level of policy restrictiveness later this year. Apart from the moderating inflation, the Fed Chair indicated that any significant weakening in the job market will also allow the Fed to begin cutting rates, given the Fed's mandate to ensure price stability and maximum employment. For now, the Fed kept its cautious approach to rate reduction given the strength in the US economy and still elevated price pressures.

Inflation moderated but remained elevated. Inflation remained the Fed's key concern which caused the FOMC to maintain the existing level of policy restrictiveness. However, the Fed admitted that the housing market, for example, has been adversely impacted by the high mortgage rates. The Fed concluded that inflation has eased from previous highs but remained above its longer-term target. Although core PCE inflation had eased to a 34-month low of +2.8%yoy in Jan-24, the latest core CPI inflation showed further moderation to +3.8% in Feb-24, also the lowest since mid-2021 albeit the reading was slightly higher than market consensus. By keeping the high interest rates, the Fed aims to bring down inflationary pressures by engineering further rebalancing in the job market which has led to slower wage pressures.

Job market remained tight despite rebalancing. The Fed reiterated that the US job market in general remained tight with excess labour demand, although job growth and vacancies had slowed from the post-pandemic highs. Nonfarm payrolls continued to increase robustly, with +275K jobs created in Feb-24 especially in the services sector. Despite the better-than-expected job creation, the recent monthly increases have been lower than average +490.5K in 2021-2022. Similarly, the number of job vacancies was 8.86m in Jan-24, lower than the recent peak of 12.18m in Mar-22. Although there is no clear deterioration in the US job market because initial claims for jobless benefits remained at low levels, the rebalancing since the aggressive rate hikes by the Fed has caused the US unemployment rate to climb to 3.9% in Feb-24, the highest reading in 2 years. With the Fed keeping its restrictive policy setting, the FOMC projected the unemployment rate to increase to 4.0% this year (Dec-23 FOMC forecast: 4.1%) before rising further to 4.1% in 2025. The prediction for a slower rise in the 2024 unemployment rate reflects the continued resilience in the job market, which will continue to support American consumer spending. In addition to the rise in the jobless rate, wage growth as measured by the change in hourly earnings has been hovering around +4.3%yoy from Oct-23 to Feb-24, slower than +5.4%yoy average monthly increases in 2022.

Fed prefers not to cut rates too soon. While keeping a balanced approach to its policy setting, the Fed decided to keep the high-interest rates for now and not too hasty in its approach to rate cuts. The Fed Chair reiterated the US central bank's preference to avoid a cutting interest rates too soon because he foresees the possible re-acceleration in inflation will require the Fed to adopt a more restrictive policy (i.e. higher interest rates) to bring inflation down to its 2% target. At the same time, the Fed is aware that keeping the high borrowing costs for too long could cause a significant slowdown in the US economy. On this note, we share the Fed's and the market's view that the Fed will eventually reduce interest rates that will provide relief to borrowers who are struggling to cope with their debt servicing following the aggressive policy tightening previously. In other words, having reached the peak of its policy tightening cycle, the Fed will likely consider reducing the level of policy restrictiveness as long as inflation continues to moderate sustainably going forward.

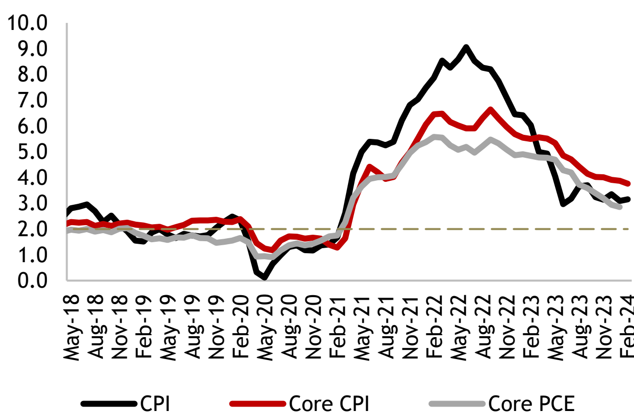
We expect the Fed to cut rates in the latter half of this year. As the underlying core inflation remains on the moderating trend, we foresee the Fed will likely cut its policy interest rate in the latter half of 2024. Understandably, the current policy setting of high interest rates is maintained to ensure inflation will move lower towards the Fed's 2% target. At the same time, the continued strength in the US job market and consumer spending could also support the US economy to grow sustainably, and may even avoid a "soft landing" as the pace of growth is expected to remain at normal levels. Nevertheless, apart from the continued resilience in the US economy, there is uncertainty that inflation will remain elevated for a prolonged period, which can be due to the persistently strong demand and wage pressures. This could cause a further delay in the Fed's decision to cut interest rates. On the flip side, if the US inflation moves sharply lower or macroeconomic conditions worsen significantly, the Fed could switch to policy easing to stimulate the economy.

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

	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Indonesia	5.75	5.75	5.75	6.00	6.00	6.00	6.00	6.00	6.00
Philippines	6.25	6.25	6.25	6.50	6.50	6.50	6.50	6.50	6.50
Thailand	2.00	2.25	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)	(0.10)	(0.10)	0.00-0.10
UK	5.00	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25
Euro area	4.25	4.25	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

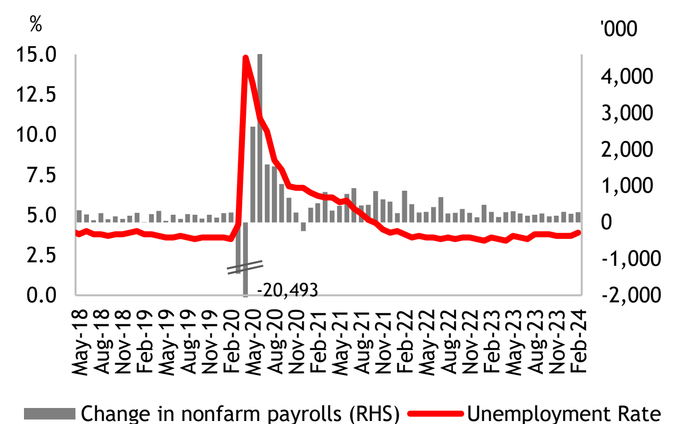
Source: Bloomberg; MIDFR

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



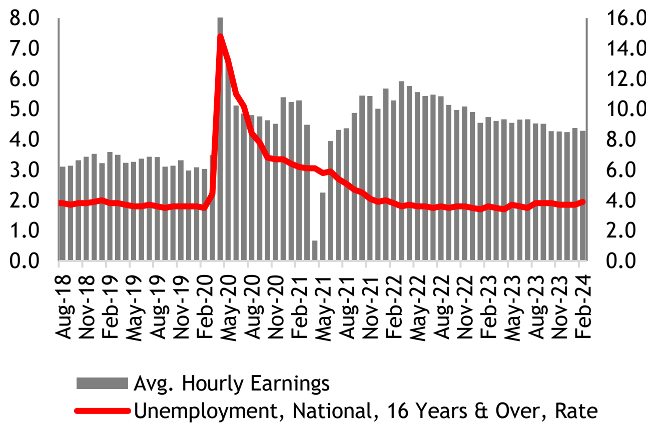
Source: Macrobond, MIDFR

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



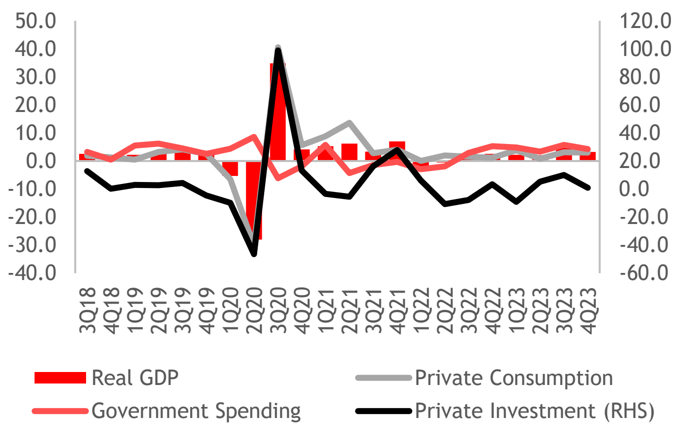
Source: Macrobond, MIDFR

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



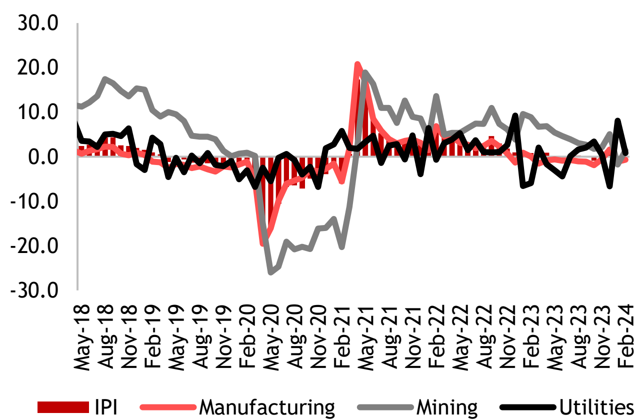
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



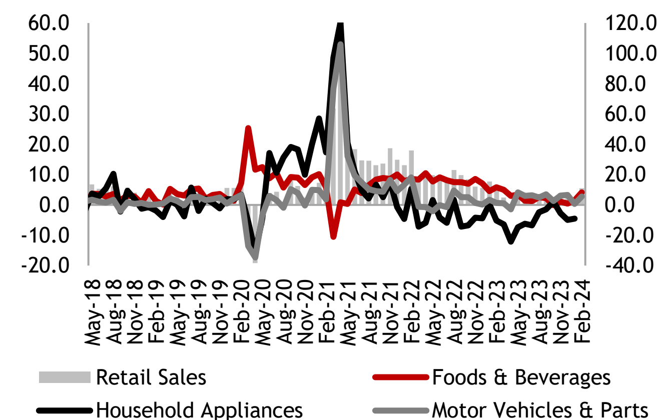
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



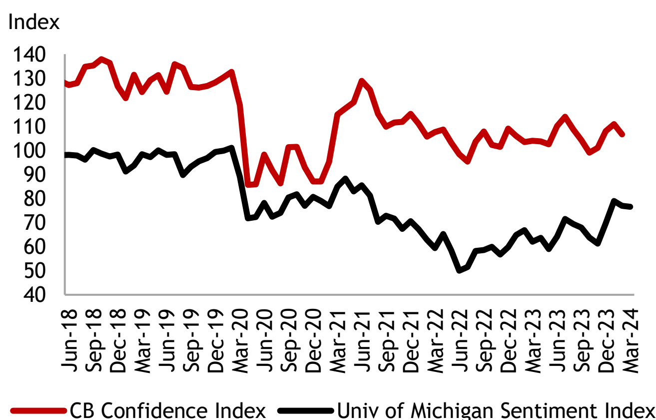
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



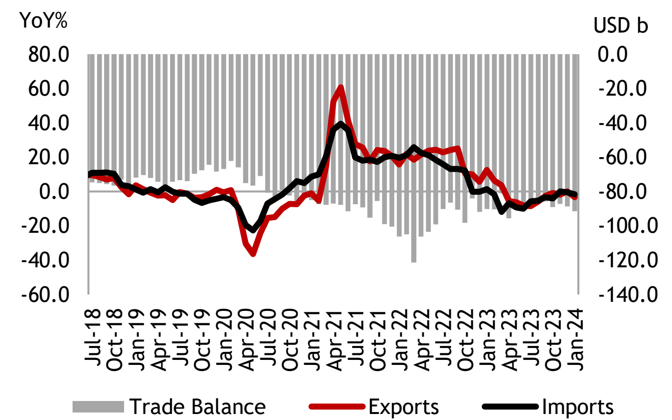
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

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



Source: Macrobond, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077 (23878 – X)).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (197501002077 (23878 – X)). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.