Economic Research Department 21 September 2023

Economic QuickView

FOMC Meeting: The Fed held interest rate steady but maintained a hawkish stance

- The FOMC decided to hold the fed funds rate steady at 5.25-5.50% at the September meeting.
- The latest forecasts indicate that interest rate will stay high for longer.
- Moderating growth and further disinflation progress are likely to keep interest rate on hold.

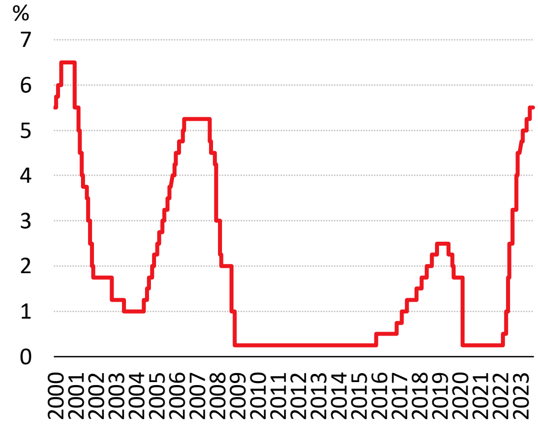
The FOMC decided to hold the fed funds rate steady at 5.25-5.50% at the September meeting. Regarding the plan for balance sheet normalisation, the Fed will continue to reduce its holdings of treasuries and agency mortgage-backed securities at a monthly cap of US$ 60 billion and US$ 35 billion, respectively. The decision was unanimous and widely expected. There were minor changes in the post-meeting statement, with the assessment of growth upgraded from moderate to solid and the labour market slightly downgraded from robust to slower job gains. These conditions were consistent with recent economic data. In delivering the forward guidance, Fed Chairman Powell highlighted that the FOMC will continue to assess the impacts of the cumulative tightening of monetary policy, as well as the developments in inflation, the economy and financial markets, to determine whether additional policy firming would be appropriate. Overall, the FOMC views the current stance of monetary policy as restrictive, and bringing inflation down to its 2% policy target remains a top policy priority.

The latest forecasts indicate that interest rate will stay high for longer. The Summary of Economic Projections (SEP) was updated at the September meeting. On the economic front, FOMC members forecast stronger growth in real GDP, a slower rise in the unemployment rate, and a continued slowdown in inflation in 2023 and 2024. The median projection for real GDP growth in 2023 was revised up to 2.1% in September from 1.0% in June. The median projection for the unemployment rate in 2023 was lowered from 4.1% to 3.8%. The median projection for core PCE inflation in 2023 was also reduced from 3.9% to 3.7%. On the policy rate front, the upgraded growth outlook likely prompted FOMC members to stay cautious in calibrating their monetary policy stance. The median projection for the fed funds rate at the end of 2023 was unchanged at 5.6%, while they revised up the median fed funds rate projection for 2024 from 4.6% to 5.1%, suggesting that the expected magnitude of rate cuts in 2024 was halved from 100 basis points (bps) in June to 50bps in September. The FOMC members also provided their economic projections for 2026, which were broadly in line with long-term trends, except that the fed funds rate wasn't expected to return to its neutral level of 2.5%. Taken together, these projections suggest that the FOMC wants to maintain a restrictive monetary environment with a high interest rate, at least in the coming year, as a resilient US economy could pose upside risks to underlying inflationary pressures.

FOMC Projections (September 2023)	2023	2024	2025	2026	Longer run
Real GDP growth (%) [June 2023]	2.1 [1.0]	1.5 [1.1]	1.8 [1.8]	1.8 [n.a.]	1.8 [1.8]
Unemployment rate (%) [June 2023]	3.8 [4.1]	4.1 [4.5]	4.1 [4.5]	4.0 [n.a.]	4.0 [4.0]
Core PCE inflation (%) [June 2023]	3.7 [3.9]	2.6 [2.6]	2.3 [2.2]	2.0 [n.a.]	-
Fed Funds rate (%) [June 2023]	5.6 [5.6]	5.1 [4.6]	3.9 [3.4]	2.9 [n.a.]	2.5 [2.5]

Source: The Fed

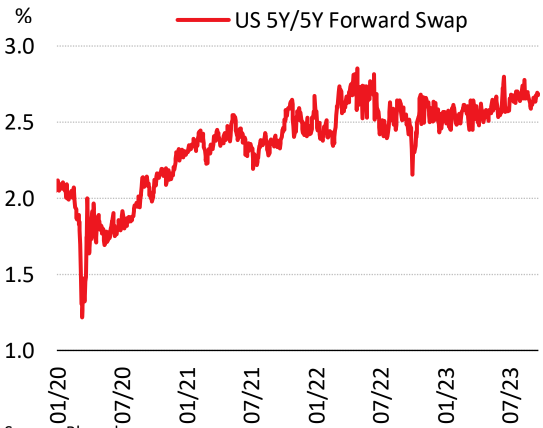
US Fed Funds Rate (Upper-bound)



Source: Bloomberg

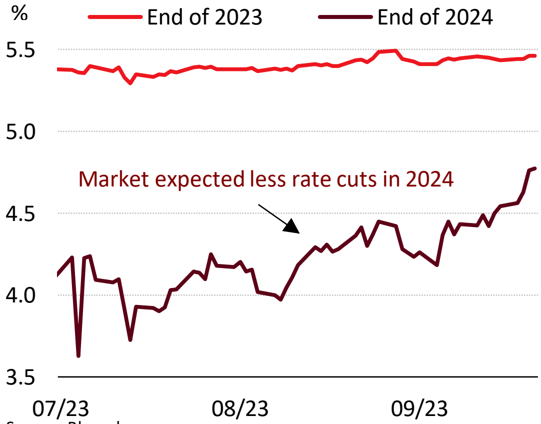
Moderating growth and further disinflation are likely to keep interest rate on hold ahead. Understandably, the Fed needs to maintain a hawkish stance by keeping the door open for further monetary tightening. At the September meeting, 7 of the 19 FOMC members expected interest rate to stay at 5.25-5.50% until the end of 2023, while the rest of them pencilling in one more hike. Indeed, this division between holding rates at current levels and further hikes was roughly unchanged from the June meeting. During the press conference, Powell stressed that there were good inflation readings over the three months from June to August, but that more progress needs to be seen. Looking ahead, we expect the US economy to moderate given the more restrictive monetary environment, the resumption of student-loan repayments, lower excess savings, and a possible government shutdown, etc. While the recent surge in oil prices and the unresolved autoworkers' strike could have implications on inflation, we note that shelter inflation (a major item in the inflation basket) has begun to cool. On balance, we expect disinflation to continue, allowing the Fed to hold rates steady going forward. As such, commercial banks in Hong Kong are also expected to stand pat if the Fed holds rates unchanged.

US Long Term Inflation Expectations



Source: Bloomberg

US Rate Expectations (futures pricing)



Source: Bloomberg

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