BEA 東亞銀行

Economic Research Department 14 December 2023

Economic QuickView

FOMC Meeting: Monetary stance goes from peak rates to a normalising downtrend in 2024

- The FOMC voted unanimously to keep the federal funds rate unchanged at 5.25-5.50%.
- The latest forecasts by FOMC members expected rates to be cut by 75 bps at 4.50-4.75% in 2024.
- Fed Chairman Powell stressed the progress of easing inflation, which will allow rates to normalise.

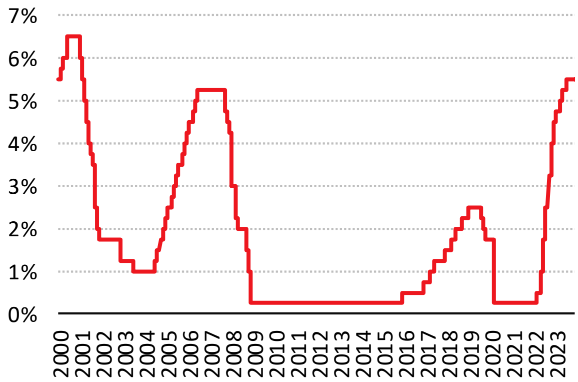
The Fed acknowledged the progress of the inflation slowdown and would proceed carefully in determining its future monetary policy. The Fed kept its monetary tools unchanged at the December meeting, in line with market expectations. While there were only minor changes in the post-meeting statement, it implied a dovish pivot for the Fed's monetary policy outlook. First, the statement highlighted that inflation has eased over the past year, reflecting the long-awaited progress that the Fed wants to see. Second, the statement added that economic growth has slowed from a strong pace in Q3 2023. This calls for the Fed to take a more balanced approach by considering the risk of overdoing it by holding a highly restrictive monetary environment for too long. Third, the statement added "any" in the description of the policy outlook (in determining the extent of any additional policy firming). Fed Chairman Powell explained in the press conference that the addition of "any" was an acknowledgement that the Fed believes that rates are likely at or near their peak for this cycle. As a whole, the Fed has been turning less hawkish since the November meeting, given the backdrop of easing inflation and slowing growth. Forward guidance from the December meeting further confirmed that the Fed is prepared to move carefully from peak rates to normalising its policy rate from an elevated level. This suggests that a pivot tilt is likely to begin in 2024.

The latest forecasts expect a faster inflation slowdown and a larger rate cut in 2024. The latest Summary of Economic Projections (SEP) shows that FOMC members expect inflation to come down faster than their forecasts in September 2023. Mostly notably, the median projections for core PCE inflation are reduced from 3.7% to 3.2% for 2023, from 2.6% to 2.4% for 2024, and from 2.3% to 2.2% for 2025. These forecasts indicate expectations for stronger progress in easing inflation toward the Fed's 2% target. Meanwhile, the growth forecast is revised up from 2.1% to 2.6% for 2023 but slightly revised down from 1.5% to 1.4% for 2024. All other economic indicators are roughly unchanged. With these macroeconomic projections, the median projections for the federal funds rate at the end of 2024 are lowered from 5.1% to 4.6%, meaning that the magnitude of expected rate cuts in 2024 is raised from 50 basis points (bps) to 75 bps. Also, 16 of the 19 FOMC members expect rate cuts in 2024 to be at least 50 bps or more at the December meeting, up from just 3 at the September meeting. In contrast to his previous remarks, Fed Chairman Powell admitted that there was a discussion of rate cuts at the meeting. This came as a surprise, as Powell just stated around two weeks ago that it was too soon to talk about rate cuts. Going forward, the timing and pace of rate cuts are likely to remain a major focus for the economy and financial markets in 2024.

FOMC Projections (December 2023)	2023	2024	2025	2026	Longer run
Real GDP growth (%) [September 2023]	2.6 [2.1]	1.4 [1.5]	1.8 [1.8]	1.9 [1.8]	1.8 [1.8]
Unemployment rate (%) [September 2023]	3.8 [3.8]	4.1 [4.1]	4.1 [4.1]	4.1 [4.0]	4.1 [4.0]
Core PCE inflation (%) [September 2023]	3.2 [3.7]	2.4 [2.6]	2.2 [2.3]	2.0 [2.0]	-
Fed Funds rate (%) [September 2023]	5.4 [5.6]	4.6 [5.1]	3.6 [3.9]	2.9 [2.9]	2.5 [2.5]

Source: The Fed

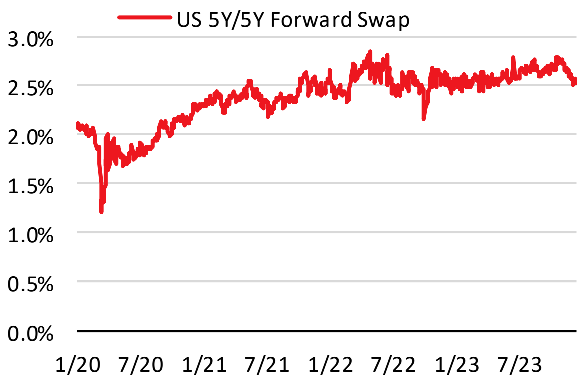
US Fed Funds Rate (Upper-bound)



Source: Bloomberg

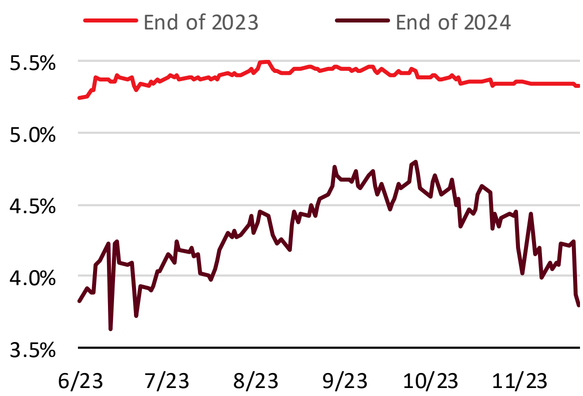
Fed Chairman Powell did not push back the recent loosening of financial conditions. In September, Fed Chairman Powell cited that rising long-term bond yields helped slow the economy and bring down inflation. However, long-term bond yields have retreated significantly since mid-October amid increasing market expectations for rate cuts in 2024 before the December meeting. It is another dovish surprise that Fed Chairman Powell did not attempt to tame these expectations during the press conference, delivering another signal that the Fed might endorse the recent loosening of financial conditions and begin preparing for its policy rate to normalise. Considering the Fed's recent dovish pivot, we expect the Fed to start cutting rates in mid-2024. In this connection, HKD interest rates are likely to follow suit. Given a smaller rise in the HK prime rate during the last rate hike cycle, the reduction in the HKD prime rate is likely to be smaller than the federal funds rate ahead.

US Long Term Inflationa Expectation



Source: Bloomberg

US Rate Expectations (futures pricing)



Source: Bloomberg

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