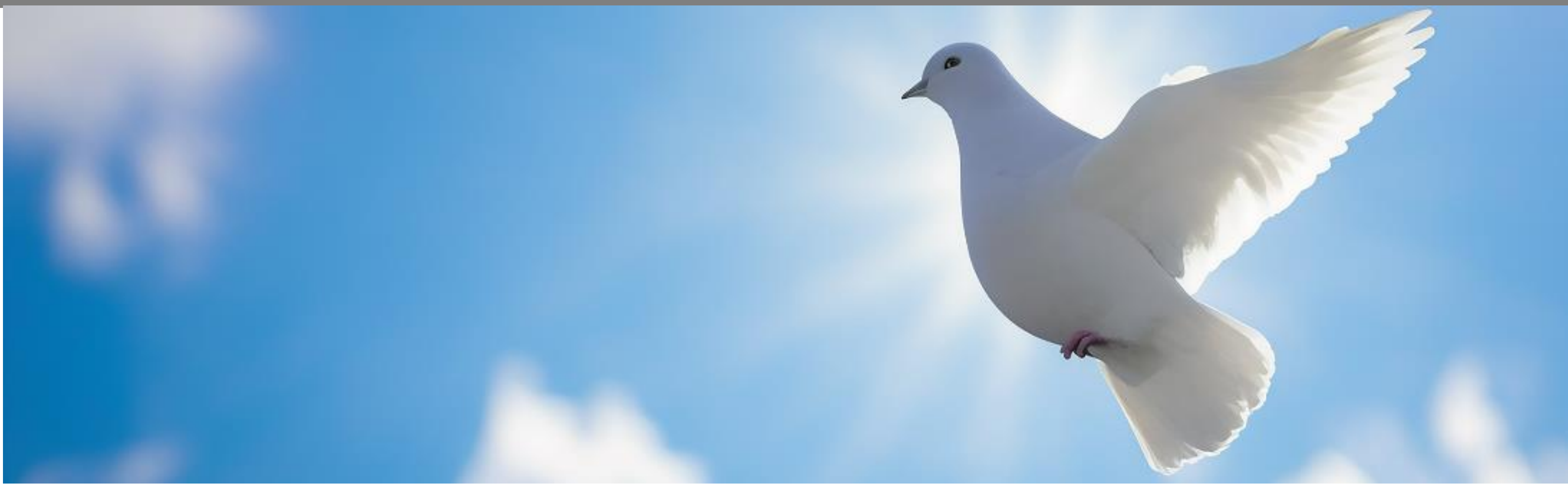
Economic Research

January 2024

Market Monitor – United States

Financial markets buoyed amid the Fed's dovish pivot

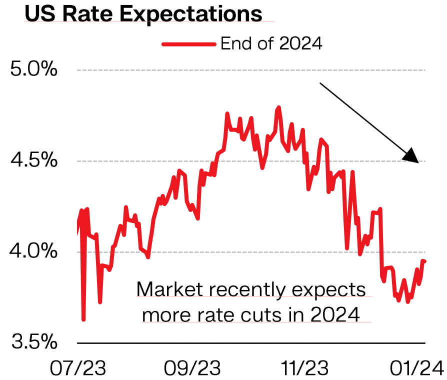


- The Fed revised up its 2024 rate cut projections to 75 bps, but a few officials pushed back the expectations of a March rate cut.
- Continued slowdown in PCE inflation was a welcome sign for the Fed, while the labour market remained solid.
- Investors' optimism was buoyed by the Fed's dovish pivot, fuelling the US stock markets to their historical highs in December 2023.

The Fed revised up its 2024 rate cut projections to 75 bps

The Fed took a surprising dovish pivot. At the December FOMC meeting, FOMC members voted unanimously to keep the federal funds rate unchanged at 5.25-5.50%. Meanwhile, there are several key revisions to the Summary of Economics Projections (SEP) as compared to September. On inflation, the median projections for core PCE inflation were lowered from 2.6% to 2.4% for 2024 and from 2.3% to 2.2% for 2025, indicating a faster disinflation outlook than previously expected. On growth, the median projections for GDP growth were revised up notably from 2.1% to 2.6% for 2023, with that for 2024 lowering from 1.5% to 1.4%. Against this macro backdrop, the median projection for rates by the end of 2024 is lowered from 5.1% to 4.6%, signalling 75 basis points (bps) of potential rate cuts in 2024, up from 50 bps in the September SEP. Furthermore, 16 of the 19 FOMC members pencilled down rates to be cut by at least 50 bps in 2024, visibly up from 3 members in the September SEP. During the post-meeting press conference, Fed Chairman Powell admitted that there were discussions on rate cuts in the meeting, which was a dovish surprise to the market. Looking ahead, the progress of the US inflation slowdown is set to remain a primary consideration for the Fed when determining the pace of rate cuts in 2024.

US Rate Expectations



Source: Bloomberg, data as of 05/01/2024

A few Fed officials pushed back the expectations of a March rate cut. After the December FOMC meeting, financial markets increasingly priced in that the Fed would start cutting rates as early as March 2024. However, recently, a few Fed officials have tried to tame such expectations. For instance, the New York Fed President said that it was "premature" to think about rate cuts in March 2024, and the Atlanta Fed President said that there was no urgency to pull off the Fed's restrictive stance. In addition, the December meeting minutes highlighted that FOMC members generally perceived a high degree of uncertainty surrounding the economic outlook, suggesting that various rate paths remained possible. These messages led to rapid swings in market expectations for the rate outlook. As of early January, futures market pricing showed that the market is pricing in about a 60% chance for the Fed to cut rates in March 2024. Overall, we expect the US Fed to start cutting rates in mid-2024.

Continued slowdown in PCE inflation is a welcome sign for the Fed. US Personal Consumption Expenditures (PCE) inflation, the Fed's preferred inflation gauge, continued to cool. Headline and core PCE year-on-year (YoY) inflation eased to 2.6% and 3.2% in November 2023, down from 2.9% and 3.4% in October, respectively. The month-on-month (MoM) growth for PCE inflation was also moderate, as headline inflation was down 0.1% and the core measure grew slightly by 0.1% in November. All these readings were below market expectations. Among the PCE basket, goods prices fell by 0.7% MoM, and services prices were only up by 0.2%, reflecting a faster inflation slowdown in goods spending. Looking ahead, the prevailing restrictive monetary environment and slowing economic growth would further ease inflationary pressures in the US.

The labour market remained solid. The labour market report in December 2023 showed solid job growth with faster wage growth. Nonfarm payrolls in December increased by 216,000, higher than market consensus, but job gains in November were revised down again. Meanwhile, average hourly earnings went up by 0.4% MoM (4.1% YoY) in December 2023, faster than expected. However, the unemployment rate was unchanged at 3.7%, reflecting a drop in both employment and participation in the household survey. On balance, a solid labour market continues to present certain inflationary risks, despite its broader softening trend since 2H 2023.

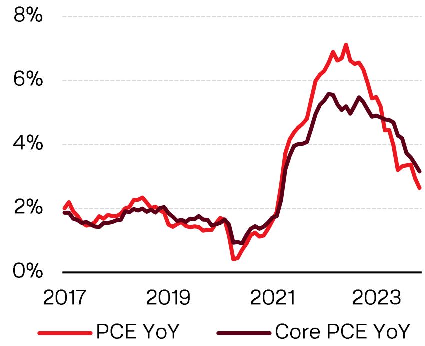
Rate-cut expectations lifted market sentiment

Investors' optimism was buoyed by the Fed's dovish pivot. In December 2023, the S&P 500, Nasdaq, and Dow Jones Industrial Average (DJIA) went up by 4.4%, 5.5%, and 4.8%, respectively, with DJIA hitting its record high, buoyed by the Fed's dovish pivot. The 10-year treasury yield was down notably by 49 bps MoM to 3.84% by the end of December 2023. The substantial drop in treasury yields was fuelled by expectations that the Fed would cut interest rates earlier than originally expected. Risk-on sentiment and rate-cut expectations sent the US dollar to weaken, with the US dollar index closing at around 103.497 at the end of December 2023, down by 3.0% MoM.

US 10-year Treasury Yield

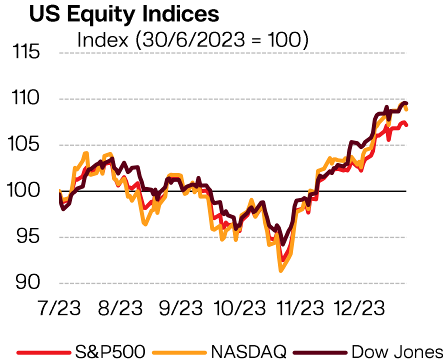
Source: Bloomberg, data as of 05/01/2024

US PCE Inflation



Source: Bloomberg, data as of 31/12/2023

US Equity Indices



Source: Bloomberg, data as of 31/12/2023

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