BEA 東亞銀行

Economic Research Department **2 May 2024**

Economic QuickView

FOMC Meeting: The Fed held rates unchanged and announced it would slow its QT

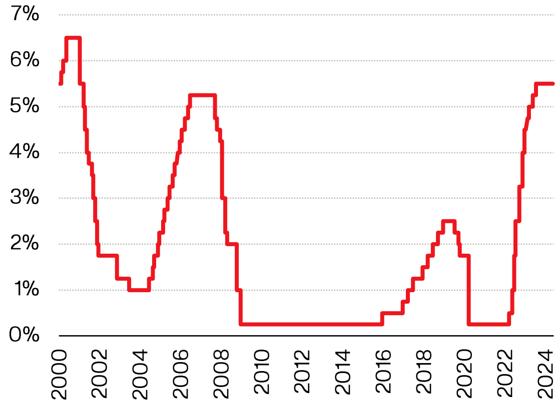
- The FOMC voted unanimously to keep the federal funds rate unchanged at 5.25-5.50%.
- Starting from 1 June 2024, the Fed will slow its pace of quantitative tightening (QT).
- The Fed Chairman, Jerome Powell, hinted that the FOMC is unlikely to hike rates but likely to hold rates higher for longer pending further progress toward its inflation objective.

The Fed returns to the monetary stance of "higher for longer". On 1 May, 2024, the FOMC voted unanimously to maintain the federal funds rate unchanged at 5.25-5.50% and announced that it would slow its pace of balance sheet reduction. The post-meeting statement highlighted a lack of further progress for inflation coming down toward the Fed's 2% target. The Fed Chairman Powell stated that *"the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent"*, suggesting that recent inflation readings have led the Fed to hold rates at a higher level for longer than previously expected.

The FOMC will slow the pace of its QT to ensure smooth money markets. With the Fed's guidance in recent months, the decision to announce a QT tapering was widely expected, but its scale was slightly above expectations. Beginning from 1 June 2024, the Fed will reduce its holdings of treasuries to a monthly cap of USD 25 billion, down from USD 60 billion, while the redemption cap on agency debt and agency mortgage-backed securities will remain unchanged at USD 35 billion. The Fed Chairman Powell noted that these changes do not mean that the Fed's overall balance sheet will ultimately shrink less than it would, but would allow the Fed's balance sheet to shrink more gradually. The objective is to ensure a smooth transition for money market operations, given the experience of money market volatility seen in the previous QT in 2019.

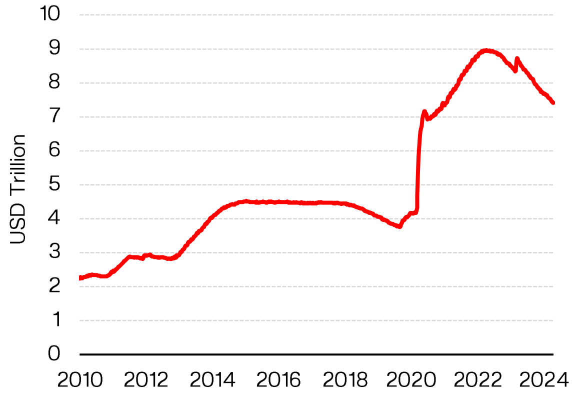
Fed Chairman Powell suggested that the risk of a hike remains low. While inflation readings have surprised to the upside for 3 months in a row, Fed Chairman Powell has remained cautious to avoid raising market speculations for a rate-hike scenario. While Fed Chairman Powell expressed his dissatisfaction with the current inflation level of around 3%, he believes that the current policy rate is restrictive enough to bring inflation back to 2% by pointing out the cooling off in labour demand and softness in interest sensitive sectors. Besides, he expects a slowdown in housing rents will have easing impacts on inflation. Regarding the economy, Fed Chairman Powell pushed back on the claims that the US would be entering stagflation, stating that current economic growth is "pretty solid", and that the core PCE price index stays at a sub-3% level. Overall, he maintains the deliberation that future monetary decisions will continue to be data dependent, but such a message was viewed as somewhat more dovish than the market expected.

US Fed Funds Rate (Upper)



Source: Bloomberg

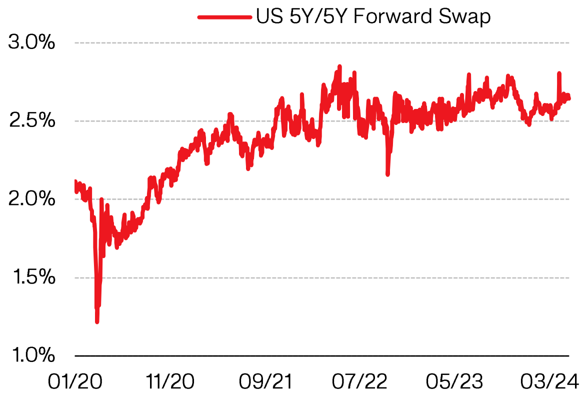
Total asset size of US Fed



Source: Bloomberg

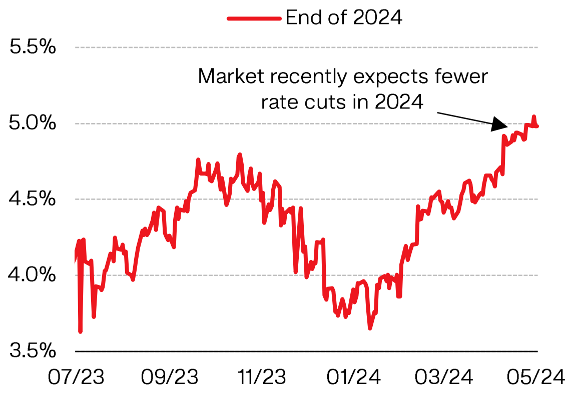
The Fed is expected to have around 1 rate cut in 2024. The May meeting clearly indicates that the Fed inclines to hold rates higher for longer with a delayed rate cut timeline. Hence, the playbook of 3 rate cuts for 2024 pencilled in its March dot plot no longer appears to be valid. At present, the futures markets are priced at around 1 rate cut for 2024. In our view, the near-term inflation outlook remains rather sticky and serves as a major source of uncertainty for the Fed. It will need several months of further disinflation progress to gain the Fed's confidence for inflation to move sustainably toward the 2% target. Thus, we expect the Fed to have around 1 rate cut in 2024, either in late Q3 or in Q4. We maintain our view that the Hong Kong dollar interest rates will follow the path of the US federal funds rate, albeit lagging somewhat behind and at a smaller magnitude compared to the US interest rates.

US Long Term Inflation Expectations



Source: Bloomberg

US Rate Expectations



Source: Bloomberg, data as of 02/05/2024

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