

Economic QuickView



FOMC Meeting: Looming possibility of a September rate cut

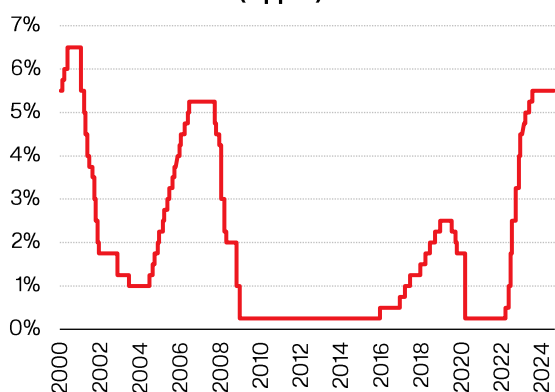
- The Fed softens its focus on inflation and becomes more attentive to both inflation and the labour market, reflecting a material shift to a more balanced stance.
- Fed Chairman Powell mentioned that a rate cut could come in September if inflation moves closer to the 2% policy target as expected.
- Our base scenario expects one 25-basis-point rate cut per quarter until the federal funds rate reaches its long-term level of around 2.75%.

The FOMC shifted its policy stance, with a balanced focus on both inflation and the labour market.

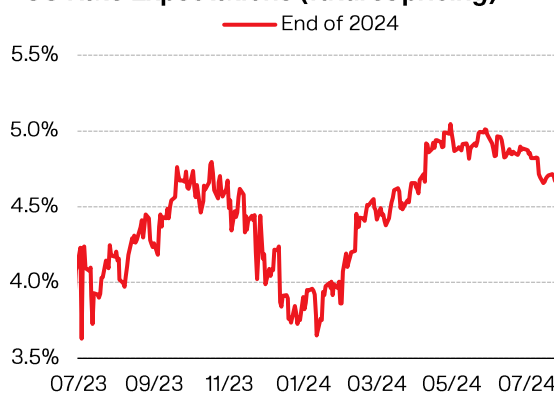
In its July meeting, the Federal Open Market Committee (FOMC) voted unanimously to maintain the federal funds rate unchanged at 5.25-5.50% and to continue to reduce its holdings of treasuries and mortgage-backed securities. In the post-meeting statement, several indications of a shift in policy stance can be seen. First, the officials toned down their assessment of the labour market, citing job gains as moderate instead of strong and highlighting the uptick in the unemployment rate. Second, some further progress in disinflation was specified. This reflected the FOMC's recognition of recent progress on disinflation. Third, the FOMC is attentive to the risks to both inflation and the labour market, marking a significant shift from the previous focus solely on inflation risks. These changes reflect that the FOMC is taking a more balanced stance in enacting its monetary policy actions ahead. In other words, the recent trends of easing inflation and moderating labour market conditions have led the FOMC to think of recalibrating its restrictive monetary stance.

Chairman Powell left the door open for a September rate cut. During the press conference, Federal Reserve (Fed) Chairman Powell said that the FOMC generally welcomed the disinflation progress made in recent months and mentioned that a rate cut could come as soon as its next meeting in September if disinflation continues. Besides, Chairman Powell said that he no longer thinks the labour market is a likely source of significant inflationary pressure, which showed a sharp contrast from his previous stance. He also revealed that there was discussion about adjusting rates in

the July meeting, but a majority thought the current disinflation was not enough to meet the conditions for rate cuts. Based on prior records, the FOMC would signal any imminent changes in policy moves by stating "soon" in describing its monetary policy outlook in its post-meeting statement. While no such guidance was given in the July meeting, the comments by Chairman Powell left the door open for a September rate cut. We consider that the Fed prefers a prudent approach to maintaining flexibility in its policy actions without pre-committing to a rate cut in September. Particularly, there are two more inflation and job market reports before the September meeting. Going forward, it is likely that the Fed will send a clearer policy signal during the upcoming Jackson Hole Economic Policy Symposium to be held on 22-24 August.

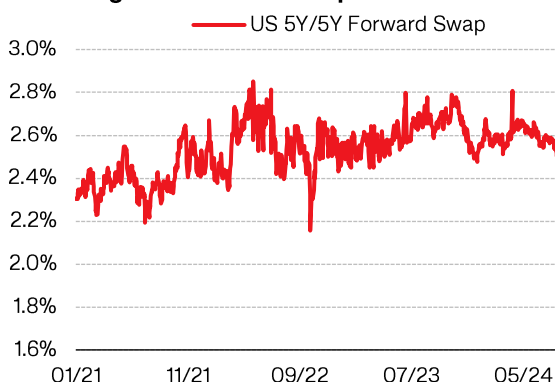
US Fed Funds Rate (Upper)


Source: Bloomberg

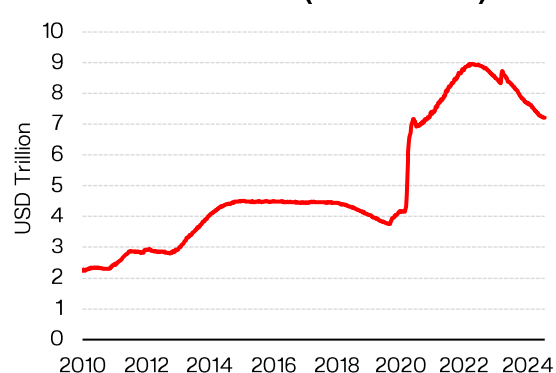
US Rate Expectations (futures pricing)


Source: Bloomberg

The existing tight monetary environment is no longer warranted. After the July meeting, financial market reactions generally pointed to rising odds for monetary easing, with notable declines seen for bond yields and the US dollar. The moderation in the labour market, specifically a gradual rise of the unemployment rate from 3.4% in April 2023 to 4.1% in June 2024, has led the Fed to get increasingly cautious about its restrictive monetary policy. Together with Chairman Powell's comments about not seeing the labour market as creating significant inflationary pressures, we view the existing tight monetary environment as no longer warranted. Our base scenario sees that the Fed will begin its rate cut cycle in September, with one 25-basis-point rate cut per quarter until the federal funds rate reaches its long-term level of around 2.75%. However, if the labour market worsens or inflation moderates more than expected, a slightly faster pace of rate cuts cannot be ruled out. On HIBOR, it is expected to follow the same trend, but the reduction of the HKD Prime Rate could come later, depending on the HKD's funding and liquidity condition as well as the bank's business strategies.

US Long Term Inflation Expectations


Source: Bloomberg

US Fed Balance Sheet (Total Assets)


Source: Bloomberg

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