Macro Note

US Jul 2023 FOMC: 25-bps Hike As Expected, Powell To Take "Meeting By Meeting", Data-Dependent Approach

Thursday, 27 July 2023

Global Economics & Markets Research
GlobalEcoMktResearch@uobgroup.com
www.uob.com.sg/research

Alvin Liew
Senior Economist
Alvin.LiewTS@uobgroup.com

- As expected, the Fed in its 25-26 Jul 2023 Federal Open Market Committee (FOMC) meeting, unanimously agreed to raise the target range of its Fed Funds Target Rate (FFTR) by 25-bps to 5.25%-5.50%, the highest in 22 years. This was the 11th rate hike in the Fed's current rate tightening cycle following a brief pause in Jun after having raised rates for ten meetings in a row since Mar 2022. The Fed also voted unanimously to raise the interest rate paid on reserve (IOER) balances by 25-bps to 5.40%.

- The Jul FOMC monetary policy statement (MPS) only contained two material changes, 1) the 25-bps increase to the FFTR and 2) the upgrade of the growth outlook to "moderate" from "modest". The greater emphasis was on Powell's post-FOMC comments. Powell mentioned he believes that monetary policy is restrictive, but with core inflation still too elevated, he said the Fed needs to keep policy restrictive till they are confident that inflation is coming down sustainably to 2%. While he was non-committal to the possible course of Fed action in Sep FOMC, his emphasis on a "meeting by meeting", data dependent approach (and yet "*afford to be a little patient, as well as resolute*") gives an overall dovish feel to his press conference.

- **FOMC Outlook – On Hold For Rest Of 2023.** The latest FOMC statement and dovish tone to Powell's latest comments reaffirm our stance that after the Jul rate hike, the Fed will be on pause for the rest of 2023 with the terminal FFTR level at 5.25-5.50%. We continue to expect no rate cuts in 2023 but with rate cuts coming in from 1Q 2024 onwards. There is a risk that the Fed will hike by one more 25-bps, but we think the Fed [hiking] cycle is at/very near the end, and it is very unlikely to see FFTR go to 6%, in our view.

Jul 2023 FOMC: A Widely Expected 25-bps Hike, Fed Signals "Meeting By Meeting" Data Dependent Approach

As expected, the US Federal Reserve (Fed), in its 25-26 Jul 2023 Federal Open Market Committee (FOMC) meeting, unanimously agreed to raise the target range of its Fed Funds Target Rate (FFTR) by 25-bps to 5.25%-5.50%, the highest in 22 years. This was the 11th rate hike in the Fed's current rate tightening cycle following a brief pause in Jun after having raised rates for ten meetings in a row since Mar 2022. Separately, the Board of Governors of the Federal Reserve System voted unanimously to raise the interest rate paid on reserve (IOER) balances by 25-bps to 5.40% with effect from 27 Jul 2023.

The Fed also maintained its commitment to "continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities as described in its previously announced plans" which means keeping to the monthly reduction of US Treasuries at US$60bn and mortgaged-back securities (MBS) at US$35bn, as stipulated in its Implementation Note.

In the Jul monetary policy statement (MPS), other than the 25-bps increase to the FFTR, the other area where there was significant change in the text was on the economy where "*Recent indicators suggest that economic activity has been expanding at a moderate pace.*" (versus "*Recent indicators suggest that economic activity has continued to expand at a modest pace*" in the Jun FOMC) which is seen as a more positive take on US growth outlook.

The bullish outlook for the labor market was unchanged, maintaining that "*Job gains have been robust in recent months, and the unemployment rate has remained low*" (unchanged from Jun FOMC). On inflation, it "*remains elevated*" and "*The Committee is strongly committed to returning inflation to its 2 percent objective.*" (also unchanged from Jun FOMC).

The Fed repeated the mention that "*The U.S. banking system is sound and resilient. Tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation. The extent of these effects is uncertain.*". It also kept the view that the FOMC will continue "*to assess additional information and its implications for monetary policy. In determining the extent of additional policy firming that may be appropriate to return inflation to 2 percent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.*" (both unchanged from Jun FOMC).

Powell's Post-Decision Press Conference: Non-Committal To Fed's Course Of Action In Sep FOMC

The most noteworthy parts of FOMC Chair Powell's commentary during the press conference after the Jul FOMC decision, was that he emphasised that the Fed is seeking evidence that inflation is "durably down" and that Fed policymakers will take a "meeting by meeting" data-dependent approach toward rate decision.

Powell mentioned he believes that monetary policy is restrictive, but pointed that core inflation is "*still pretty elevated*" and added "*what our eyes are telling us is policy has not been restrictive enough for long enough to have its full desired effects…We intend again to keep policy restrictive until we're confident that inflation is coming down sustainably to our 2% target, and we're prepared to further tighten if that is appropriate. And we think the process still probably has a long way to go.*"

Powell refused to commit to what the Fed will do at the next meeting, highlighting there are two more sets of inflation and two more sets of jobs data to go before 19-20 Sep FOMC. He said: "*We have to be ready to follow the data, and given how far we've come, we can afford to be a little patient, as well as resolute.*" And "*all of that information is going to inform our decision as we go into that meeting…It is certainly possible that we would raise [rates] again at the September meeting, if the data warranted. And I would also say it's possible that we would choose to hold steady at that meeting.*"

On the issue of rate cuts, Powell again suggested rate cuts are unlikely to happen in 2023. As for rate cuts in 2024, Powell said it is going to be a "judgement" call the Fed will make based on how "confident" they are.

Powell said that the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) shows an overall picture of tighter and still tightening credit conditions. The comment was in line with the FOMC statement that "*tighter credit conditions* *for households and businesses are likely to weigh on economic activity, hiring, and inflation*."

Powell also revealed that Fed staff economists are no longer forecasting a recession in 2023 given the recent resilience of US economy (which is not surprising given the better than expected performance of several US macro and survey data) but are still expecting a noticeable growth slowdown later this year.

Maintaining Our FOMC Outlook – On Hold For Rest Of 2023

While the latest FOMC decision was widely anticipated and the FOMC statement was little changed from the previous iteration (except for the upgrade of the growth outlook to "moderate" from "modest"), the greater emphasis was on Powell's post-FOMC comments. While he was non-committal to the possible course of Fed action in Sep FOMC, his emphasis on a "meeting by meeting", data dependent approach (and yet "*afford to be a little patient, as well as resolute*") gives an overall dovish feel to his press conference.

As such, we keep our call that after the Jul rate hike, we expect the Fed to be on pause for the rest of 2023 with the terminal FFTR level at 5.25-5.50%. We continue to expect no rate cuts in 2023 but with rate cuts coming in from 1Q 2024 onwards. There is a risk that the Fed will hike by one more 25-bps but we think the Fed [hiking] cycle is at/very near the end, and it is very unlikely to see FFTR go to 6%, in our view

On the topic of recession outlook in the US, the risks of such an outturn have diminished further on the back of a resilient labour market. However, one should not discount outright such an occurrence especially if the "restrictive" conditions continue and cause more severe consequences.

Again, it should be noted that these forecasts are subject to incoming data and credit tightening conditions. According to trading in futures data compiled by Bloomberg (WIRP) (as of 27 Jul), the probability of a 25-bps rate hike in Sep FOMC is at a low 20% while rate cuts expectations are priced in for 1Q 2024 onwards.

There is no FOMC meeting in Aug and the next one will be on 19-20 Sep 2023 and the decision will be accompanied by Powell's press conference together with an updated Summary of Economic Projections (SEP) and the Dotplot chart.

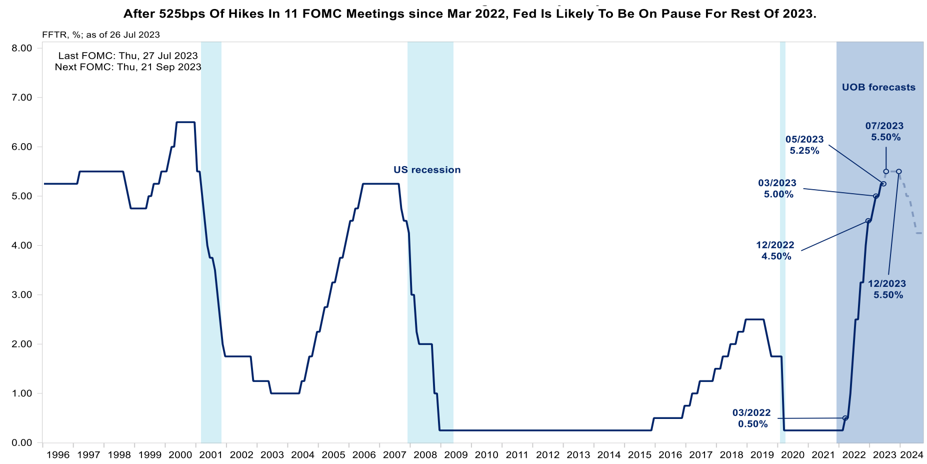
The immediate data focus will be on the US advance 2Q 2023 GDP estimates later today (27 Jul, Bloomberg est 1.8% q/q SAAR from 2% in 1Q). Key data ahead of the Sep decision include two sets of PCE by BEA (28 Jul and 31 Aug), two sets of US jobs data by the BLS (4 Aug and 1 Sep), and two sets of CPI data by BLS (10 Aug and 13 Sep). We will have an opportunity to re-assess our Fed policy view after the Jackson Hole Symposium (24-26 Aug) if Powell does use this platform to signal any major Fed policy changes.

Please use the following addresses to access the official Fed documents:

i. The 25-26 Jul 2023 FOMC statement;
(https://www.federalreserve.gov/newsevents/pressreleases/monetary20230726a.htm)
ii. The Jul 2023 FOMC implementation note (interest rate paid on reserves, IOER, raised by 25bps to 5.40%, effective from 27 Jul 2023);
(https://www.federalreserve.gov/newsevents/pressreleases/monetary20230726a1.htm)
iv. The FOMC calendar for 2023.
(https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm)

Chart 1: UOB's Projected US Federal Funds Target Rate Trajectory (As Of 27 Jul 2023)

Source: Macrobond, UOB Global Economics & Markets Research



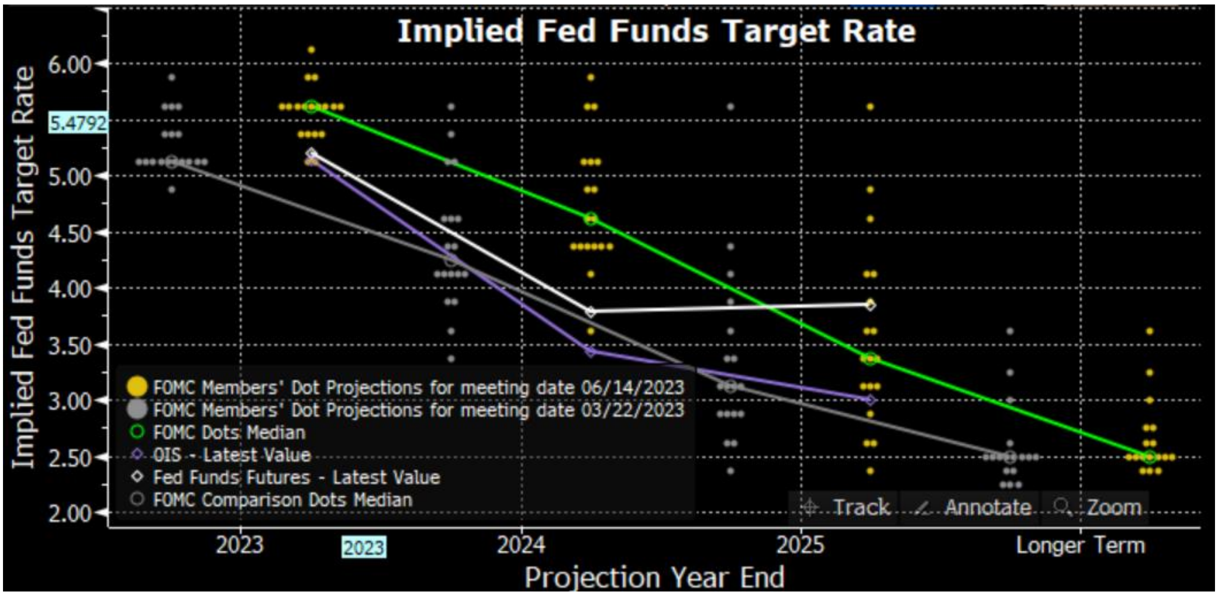
Our Forecast

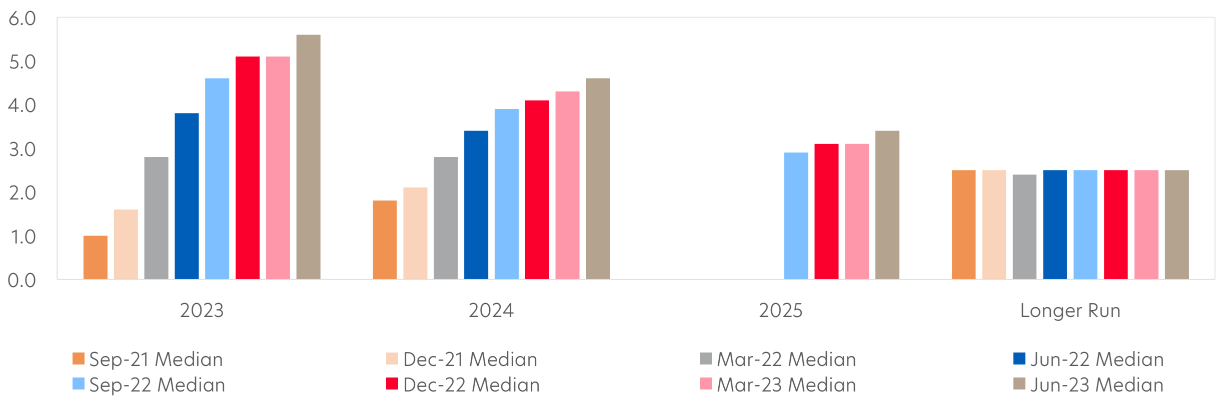
%	As of 26 Jul	3Q23	4Q23	1Q24	2Q24
US Fed Funds Target - Upper Bound	5.50	5.50	5.50	5.00	4.50

Source: Global Economics & Markets Research (as of 26 Jul 2023)

Chart 2: Jun 2023 vs Mar 2023 Dot Plot Chart Rate Comparison & History Of Past Projections

Source: Macrobond, The Federal Reserve, UOB Global Economics & Markets Research





Right By You

Economic Projections of US Federal Reserve Board, June 2023				
Variable	Central Tendency			
	2023	2024	2025	Longer Run
Change in real GDP	0.7–1.2 (↑)	0.9–1.5 (↓)	1.6–2.0 (↓)	1.7–2.0 (-)
March 2023 projection	0.4–1.0 (↓)	1.3–2.0 (↓)	1.6–2.0 (-)	1.7–2.0 (-)
December 2022 projection	0.5 - 1.5 (↓)	1.4 - 2.0 (↓)	1.6–2.0	1.7 - 2.0 (↓)
September 2022 projection	1.3 - 2.0 (↓)	1.5 - 2.0 (↓)		1.8 - 2.0 (-)
Unemployment rate	4.0–4.3 (↓)	4.3–4.6 (↓)	4.3–4.6 (↓)	3.8–4.3 (-)
March 2023 projection	4.4–4.7 (↑)	4.3–4.8 (↑)	4.0–4.7 (↑)	3.8–4.3 (↑)
December 2022 projection	4.1 - 4.5 (↑)	4.0 - 4.6 (↑)	4.0 - 4.5	3.8 - 4.3 (↑)
September 2022 projection	3.8 - 4.1 (↑)	3.9 - 4.1 (↑)		3.5 - 4.2 (-)
PCE inflation	3.0–3.5 (↓)	2.3–2.8(↑)	2.0–2.4(↑)	2.0 (-)
March 2023 projection	2.9–3.5 (↑)	2.3–2.7(↑)	2.0–2.2	2.0 (-)
December 2022 projection	2.6 - 3.5 (↑)	2.1 - 2.6 (↑)	2.0 - 2.2	2.0 (-)
September 2022 projection	2.4 - 3.0 (↑)	2.0 - 2.5 (↑)		2.0 (-)
Core PCE inflation	3.7–4.2 (↑)	2.5–3.1 (↑)	2.0–2.4(↑)	
March 2023 projection	3.2–3.7 (↑)	2.3–2.7 (↑)	2.0 - 2.2 (-)	
December 2022 projection	3.0 - 3.4 (↑)	2.2 - 2.5 (↑)	2.0 - 2.2	
September 2022 projection	2.5 - 3.0 (↑)	2.1 - 2.5 (↑)		
Federal Funds Rate	5.4–5.6 (↑)	4.4–5.1 (↑)	2.9–4.1 (↑)	2.5 - 2.8 (↑)
March 2023 projection	5.1–5.6 (↑)	3.9–5.1 (↑)	2.6–3.9 (-)	2.4 - 2.6 (↑)
December 2022 projection	5.1–5.4 (↑)	3.9–4.9 (↑)	2.6–3.9 (↑)	2.3 - 2.5 (-)
September 2022 projection	4.4 - 4.9 (↑)	3.4 - 4.4 (↑)	2.4 - 3.4	2.3 - 2.5 (-)
	Median			
Change in real GDP	1.0 (↑)	1.1 (↓)	1.8 (↓)	1.8 (-)
March 2023 projection	0.4 (↓)	1.2 (↓)	1.9 (↑)	1.8 (-)
December 2022 projection	0.5 (↓)	1.6 (↓)	1.8 (-)	1.8 (-)
September 2022 projection	1.2 (↓)	1.7 (↓)	1.8	1.8 (-)
Unemployment rate	4.1 (↓)	4.5 (↓)	4.5 (↓)	4.0 (-)
March 2023 projection	4.5 (↓)	4.6 (-)	4.6 (↑)	4.0 (-)
December 2022 projection	4.6 (↑)	4.6 (↑)	4.5 (↑)	4.0 (-)
September 2022 projection	4.4 (↑)	4.4 (↑)	4.3	4.0 (-)
PCE inflation	3.2 (↓)	2.5 (-)	2.1 (-)	2.0 (-)
March 2023 projection	3.3 (↑)	2.5 (-)	2.1 (-)	2.0 (-)
December 2022 projection	3.1 (↑)	2.5 (↑)	2.1 (↑)	2.0 (-)
September 2022 projection	2.8 (↑)	2.3 (↑)	2.0	2.0 (-)
Core PCE inflation	3.9 (↑)	2.6 (-)	2.2 (↑)	
March 2023 projection	3.6 (↑)	2.6 (↑)	2.1 (-)	
December 2022 projection	3.5 (↑)	2.5 (-)	2.1 (-)	
September 2022 projection	3.1 (↑)	2.3 (-)	2.1	
Federal Funds Rate	5.6 (↑)	4.6 (↑)	3.4 (↑)	2.5 (-)
March 2023 projection	5.1 (-)	4.3 (↑)	3.1 (-)	2.5 (-)
December 2022 projection	5.1 (↑)	4.1 (↑)	3.1 (↑)	2.5 (-)
September 2022 projection	4.6 (↑)	3.9 (↑)	2.9	2.5 (↑)
Source: US Federal Reserve				

Disclaimer

Right By You