POLICY RATE VIEWS

FED PAUSES OUT OF CAUTION

Fed Action

The latest FOMC meeting ended all speculations after the US Federal Reserve (Fed) delivered the anticipated pause, keeping the target range for the federal funds rate (FFR) at 5.0% - 5.25%.

Powell however explained that the pause was merely a cautious step by the Fed to give it time to gather more information before deciding on rate increases. He emphasized that the speed of rate adjustments is not as important as identifying the right point at which to slow down price increases while keeping unemployment from rising too much.

Fed Signals and New Projections

Despite the expected pause, the Fed signaled that borrowing costs may still need to rise by as much as half a percentage point (implying two 25-basis point hikes), due to its recent quarterly projections which showed that there has been a slight increase in growth estimates (from 0.4% in March to 1% in June by end-2023), a slight decrease in unemployment estimates, and an increase in inflation estimates (from core PCE inflation estimate of 3.6% to 3.9% by end-2023).

The new Fed funds terminal rate projections have gone up, implying two more rate increases this year and cuts possibly next year.

US Inflation Trajectory

US headline inflation further eased from 4.9% in April to 4.0% in May, the lowest since March 2021 and lower than the consensus median estimate of 4.1%, which strengthened the case for a pause by the Fed. However, core CPI remained sticky at 5.3% indicating persistent price pressures. Meanwhile, Producer Prices also eased in May suggesting waning price pressures throughout the economy.

Given this, Research's full-year inflation forecast for the US is now at 3.7%, lower than previous FY estimates with Q4 ending still slightly above the 2% target of the Fed. Meanwhile, FY 2024 US CPI inflation is seen averaging back to the 2.2% level.

Latest Fed Funds Rate (FFR) hike:

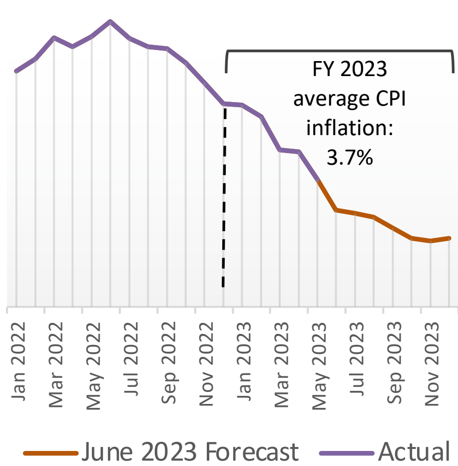
±0 bps

FFR Target Range as of June 15, 2023

5.00% to 5.25%

Fed Funds Terminal Rate Projections	
as of Mar 2023	as of Jun 2023
2023: 5.1% **2024: 4.3%**	**2023: 5.6%** **2024: 4.6%**

US Inflation Forecast for 2023



READING THROUGH THE SIGNALS AND POTENTIAL SCENARIOS

The Fed's strong signal of potentially two more hikes is a rather surprising move given recently improving inflation numbers. However, its recent stance is likely a by-product of a multitude of factors such as improved growth and unemployment estimates amid a still elevated albeit decelerating inflation, with core estimates for the year higher than that from March – all these after having tightened 10 times in a row since 2022.

- These signals, however, could simply be a move for the Fed to manage market expectations allowing them more room to maneuver.
  - Putting out these signals gives the Fed more options as they assess the impact of past monetary tightening on the overall economy, which takes time before the overall impact can be felt. At the very least, the Fed is signaling to the market not to expect any premature monetary easing, meaning a pause is still possible.
- On the other hand, if the Fed does follow through with its signals as it had done so in the past, that might put a constraint on the BSP from doing monetary easing as well even if domestic conditions may warrant it. At the very least, the BSP might keep rates where they are even if the Fed hikes, if the Fed is expected to cut in 2024 anyway.
- Further signals from the BSP in its June 22 rate-setting meeting might shed more light on their next steps as they weigh their price stability efforts versus the Fed's recent hawkish signals.