Metrobank
Research and Business Analytics

POLICY RATE VIEWS

FED POLICY RATES UNCHANGED

Fed Action

The first Federal Open Market Committee (FOMC) meeting yesterday, January 31, matched market expectations as the US Federal Reserve maintained the Federal Funds Target Rate (FFR) at 5.25% - 5.50%. This was the fourth consecutive meeting that the FOMC decided to hold policy rates steady, following a string of 11 rate hikes, including four in 2023.

Fed Signals

The Fed now sees the balance of risks to achieving its inflation and employment goals as balanced. Powell also indicated that the Fed does not need to see a weakening labor market before it begins normalizing policy. This was a stark departure from last year's comments, which focused on seeing better balance in the labor market as key to bringing down core inflation. Powell also emphasized that the policy rate is likely at the peak of the current tightening cycle and may keep rates on hold. Before cutting interest rates, the Fed needs more confidence on the continuous downward trend of inflation towards the 2% target. This effectively signaled to the markets that rates may remain higher for longer, further supported by comments that a rate cut in March is not the Fed's base case at this point.

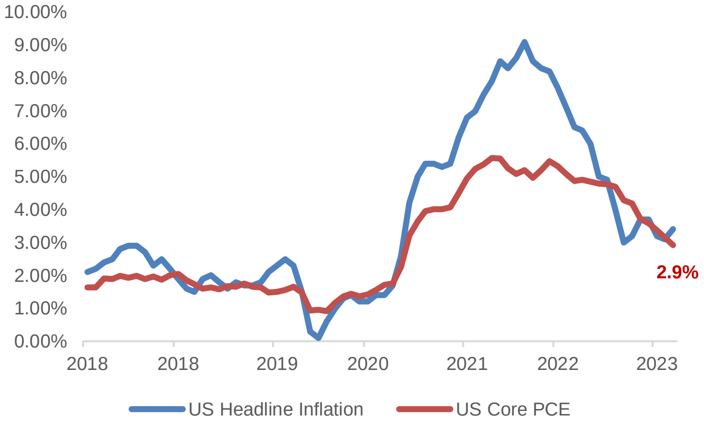
Meanwhile, Powell also indicated that there will be an in-depth discussion about the path of Quantitative Tightening (QT) in the next month. The Fed views the policy rate and balance sheet as two separate policies and cutting rates would not mean it would end QT immediately.

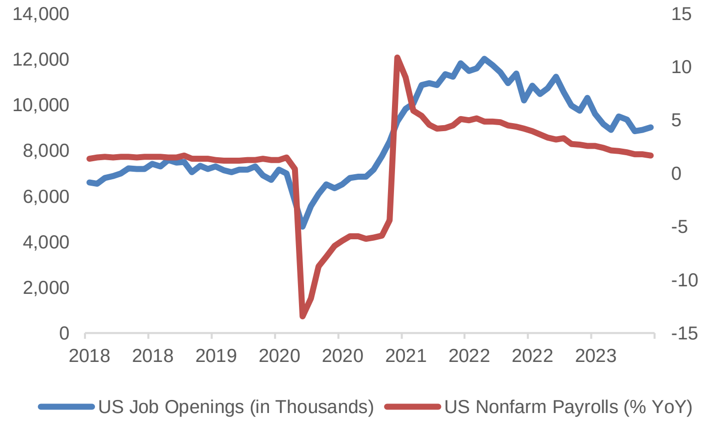
Fed Funds Target Rate as of February 1, 2024

5.25% to 5.50%

Strong US Economic Data

Economic data releases in 2024 have so far proven resilient. The Fed's favored inflation measure, the core Personal Consumption Expenditures (PCE) Price Index, fell to 2.9% in December 2023 from 3.2% in November. The US economy expanded more quickly, with full year Gross Domestic Product (GDP) climbing to 2.5%. The jobs market, on the other hand, was stronger with the unemployment rate in December clocking in at 3.7%. Average hourly earnings rose to 4.1% year-on-year from 4.0% in November. Nonfarm Payrolls rose by 216,000 in December, much higher than the market expectation of 170,000. Lastly, the Job Openings and Labor Turnover Survey (JOLTS) showed that the number of job openings stood at 9.02 million, higher than the 8.92 million openings in November and estimates of 8.75 million.





FORECAST & OUTLOOK

- Following the recent slew of data that continue to indicate strong economic growth and a still-strong labor market in the US, along with Fed Chair Powell's outright pushback on the likelihood of a rate cut March, we have re-weighed our base case and now expect that the first of the Fed's rate reductions will likely happen in the second quarter.
- We maintain our view that the Fed will likely cut by a total of 100 bps this year, vs the market's current expectation of 143 bps. We expect the pace of the Fed's easing to be more gradual than what the market is currently pricing-in, as we acknowledge the risk of loosening financial conditions against a backdrop of still-elevated US inflation.
- Given this divergence in expectations, even vs the Fed's projection of only 75 bps in cuts as indicated by the latest dot plot from December, we recognize the risk of higher US yields in the near-term, especially if the upcoming data releases before the next FOMC meeting in March continue to indicate stickier inflation and persistent tightness in the labor market.
- We continue to expect the BSP to stay relatively more hawkish, likely to lag the Fed's first cut by up to a full quarter, as we see stickier domestic price pressures vs in the US.