Metrobank

Research and Market Strategy Department

POLICY RATE VIEWS

FED'S BREATHER: TAKING A PAUSE AFTER CONSECUTIVE CUTS

Fed maintains policy rate

The US Federal Reserve (Fed) maintained the Federal Funds Target Rate (FFR) at 4.25% to 4.50% at the Federal Open Market Committee (FOMC) meeting on January 28-29, as widely expected by financial-market players. This is the first time that the Fed paused its latest easing cycle after a total 100-basis-point (bps) worth of reductions made in the preceding three meetings.

Following the FOMC meeting on January 29, Fed Chair Jerome Powell continued to acknowledge that inflation has "moved much closer to the 2% longer-run goal, though it remains somewhat elevated." He also highlighted the strong labor market, noting that job conditions remain "broadly in balance" and are not a source of significant inflationary pressure.

Powell supported his December stance that the Fed can now "afford to be a little more cautious," given the strong state of the US economy. He emphasized the importance of the pace and magnitude of rate cuts in both inflation and the labor market.

In response to a question on the impact of President Donald Trump's proposed policies, Powell reiterated that Fed officials are still waiting for how specific policies play out, particularly those related to tariffs, immigration, fiscal measures, and regulatory changes to properly assess their implications to the economy. He noted that while short-term inflationary expectations are slightly rising due to these policy uncertainties, long-term expectations are more significant and remain stable.

Related article: Fed Preview: Starting the year with a break

Fed Funds Target Rate as of January 30, 2024

4.25% to 4.50%

US economic data

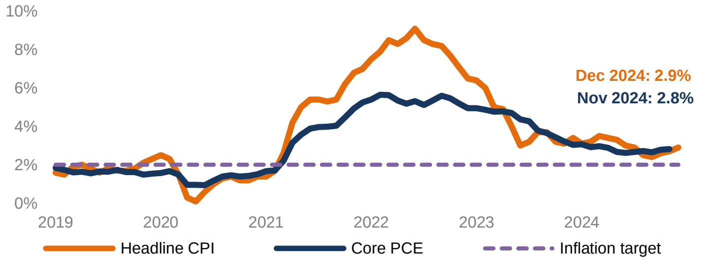
The Fed's preferred inflation measure, the US Core Personal Consumption Expenditure (Core PCE) Price Index, remained relatively calm in 2024, with the latest print in November settling at 2.8% year-on-year (YoY). The print is roughly the same pace as in October after prices generally decelerated across all the components of core PCE, offset by upward pressure from the slower deceleration in the prices of durable goods.

Meanwhile, headline Consumer Price Index (CPI) picked up slightly in December at 2.9% YoY, which also brought full-year inflation to 2.9%. Although the print continues to approach the Fed's target of 2%, the increase of food prices largely influenced CPI growth. Despite this, shelter prices remain the main contributor to headline CPI, although its contribution has been on a decline in recent months as price increases decelerate. On a month-on-month (MoM) basis, headline CPI accelerated by 0.4% in December, logging the sixth consecutive MoM increase in the second half of 2024. The MoM acceleration is mainly driven by the increase in energy prices.

The job market showed great improvements in the past few months especially after the Boeing labor union strikes were resolved. Non-Farm Payrolls increased by 256,000 month-on-month in December, driven by a substantial increase in payrolls across the Trade, Transportation, and Utilities industries. Meanwhile, initial jobless claims saw only a slight increase, rising to 223,000 in the third week of January from 217,000 in the preceding week. Although unemployment remains sticky at 4.1% as of end-2024, the relatively low level still supports the notion of a solid US labor market.

US Inflation

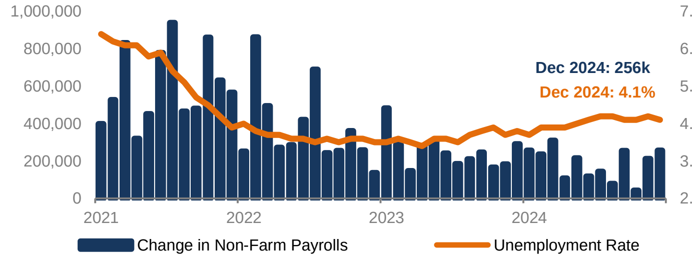
US Core PCE and Headline CPI



Source: Bloomberg

US Labor Market

US Non-farm Payrolls and Unemployment Rate



Source: Bloomberg

METRO RESEARCH'S TAKE

The recent policy decision by the Fed met expectations. Metrobank Research maintains its baseline forecast that the Fed will continue its easing cycle in 2025 with a total of 75 bps in cuts, though these will be delivered at a moderate pace. This less dovish stance is due to higher short-term inflation expectations in the US, influenced by policy uncertainties with the new administration.

Despite this, the target FFR is still anticipated to reach its terminal rate of 3.00% by end-2026.

On the domestic front, Metrobank Research forecasts a cumulative 75 bps reduction in policy rates by the Bangko Sentral ng Pilipinas (BSP) this year, as inflation is expected to remain target-consistent, barring any supply-side shocks. The team also anticipates a 25-bp cut at the BSP's first Monetary Board meeting in February to support economic growth, despite the less dovish outlook from the Fed. This would bring the BSP's target reverse repurchase (RRP) rate down to 5.50%, narrowing the interest rate differential (IRD) between the BSP and the Fed to 100 bps.

Although a narrower IRD, together with the persistent strength of the dollar, will exert some pressure on the spot, the pass through of current peso depreciation to inflation remains minimal, according to BSP estimates. Additionally, the BSP has the capacity to support the peso given its current level of reserves should peso depreciate further than anticipated.