

# Initial Thoughts on FOMC Decision

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# Hawkish Message of Higher for Longer

## Hint of a Further Rate Hike Attributed to Strong Economy

- Today, the Federal Open Market Committee (FOMC) unanimously decided to maintain the policy interest rate—the target range for the federal funds rate—at 5.25%-5.50%. Being accompanied by an augmented level of quantitative tightening, allowing redemption of securities held at a faster pace in September of last year, the Federal Reserve’s (the “Fed”) stance on overall monetary policy remained tight.
- The Fed’s policy stance remains unchanged, as expected. However, the quarterly updated economic outlook (the Summary of Economic Projections, or SEP) was clearly revised upwards, and this was one of the reasons for maintaining the assumption of one more interest-rate hike by the end of the year. The policy statement was even revised upward based on the actual state of the economy. This may have come as a surprise to those who were concerned about when the Fed would start lowering interest rates due to the easing of inflationary pressures and the slowing pace of employment growth as early as 2024.
- In the statement, the economic assessment was revised from “expanding at a moderate pace” to “expanding at a solid pace.”
- In the SEP, the real GDP growth rate was revised upward significantly for 2023, from 1.0% in July to 2.1%, and also for 2024 from 1.1% to 1.5%. This means that the tightness of the macro demand-supply balance will become even stronger. The projected unemployment rate has also been broadly reduced from 4.1% to 3.8% in 2023, from 4.5% to 4.1% in 2024, and from 4.5% to 4.1% in 2025. FOMC members are estimating the long-term average unemployment rate to be 4.0%. In other words, the scenario is that the unemployment rate will remain near a neutral level in the economy over the next few years. Overall, the message is that they are predicting that the U.S. economy will undergo no recession.
- The core Personal Consumption Expenditures deflator was revised downward from 3.9% in 2023 to 3.7%, but remained unchanged at 2.6% in 2024, and slightly revised upward to 2.3% in 2025 from the previous 2.2%. Importantly, this implies that Fed officials expect to see a stable return to the 2% target only after the second half of 2025.

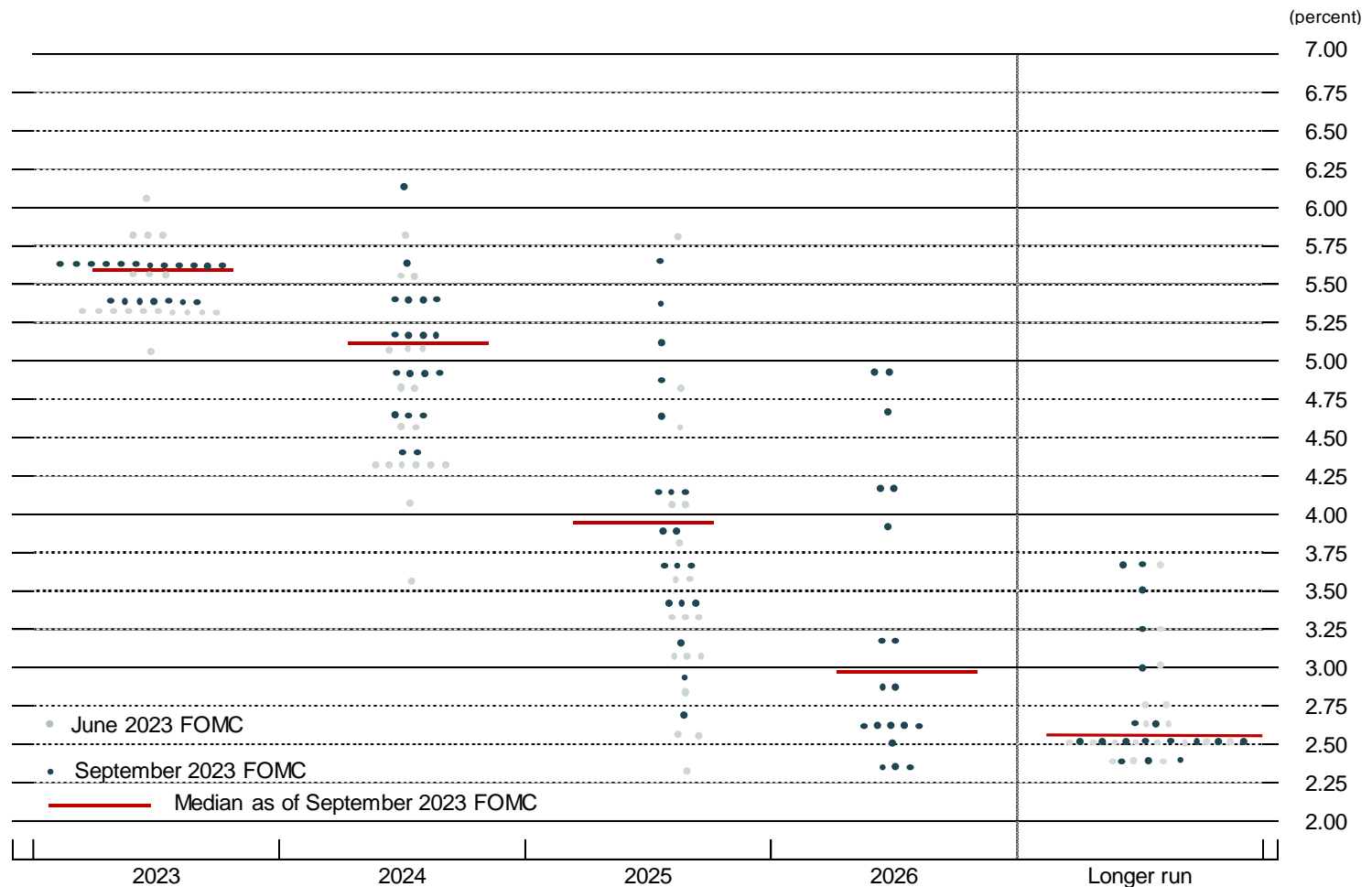
## Likelihood of Another Rate Hike

- At the post-meeting press conference, Fed Chair Jerome Powell hinted at the possibility of one more rate hike this year. The FOMC members’ assumptions of the policy rate for the forecast period were: 5.1% in 2024, 3.9% in 2025, and 2.9% in 2026. These were higher than 2.5%, which is widely regarded as the “neutral” policy rate in the long run. Compared to the previous SEP as of June, both 2024 and 2025 have been revised upward by 0.5%. This is a so-called “higher for longer” policy, and the message is to be prepared that it will take a considerable amount of time to stabilize and contain inflation in a steady manner.
- However, the action of the Fed is still data-dependent. When considering how realistic it is to raise interest rates again for this year, we need to examine where the current actual policy interest rate is relative to the interest-rate level that is considered neutral from the perspective of the economy and prices. If even a rate hike of more than 5% is not enough to reach the neutral level, further rate hikes will become more realistic. On the other hand, if the current interest rate has already significantly exceeded the estimated neutral rate, then Chair Powell’s bullish comments can be interpreted as nothing more than an announcement aimed at calming inflation expectations, implying there will be no more interest-rate hikes this year.
- Based on the Taylor rule estimated by the Federal Reserve Bank of New York and the updated SEP, the latest interest-rate hike would finally reach a neutral level. Since the pandemic started in early 2020, policy interest rates have consistently fallen short of the rule value, even in the process of aggressive hikes of over 500 basis points.
- If the interest rate is raised one more time, it will finally catch up with the Taylor rule value and the policy rate will exceed the neutral rate thereafter, suggesting that the degree of monetary tightening will gradually increase.
- If this analysis and sense of the policy rate level is shared among all FOMC members, and the economy gradually slows down after the surge in demand this summer, there will not necessarily be an interest-rate hike within this year, and the current interest-rate level will remain unchanged for a long time.

# Hawkish Message of Higher for Longer (continued)

- FOMC members believe the appropriate policy rate should remain above the 2% target during the period from 2023 to 2026. The median level was revised up by 0.5% for both 2024 and 2025.

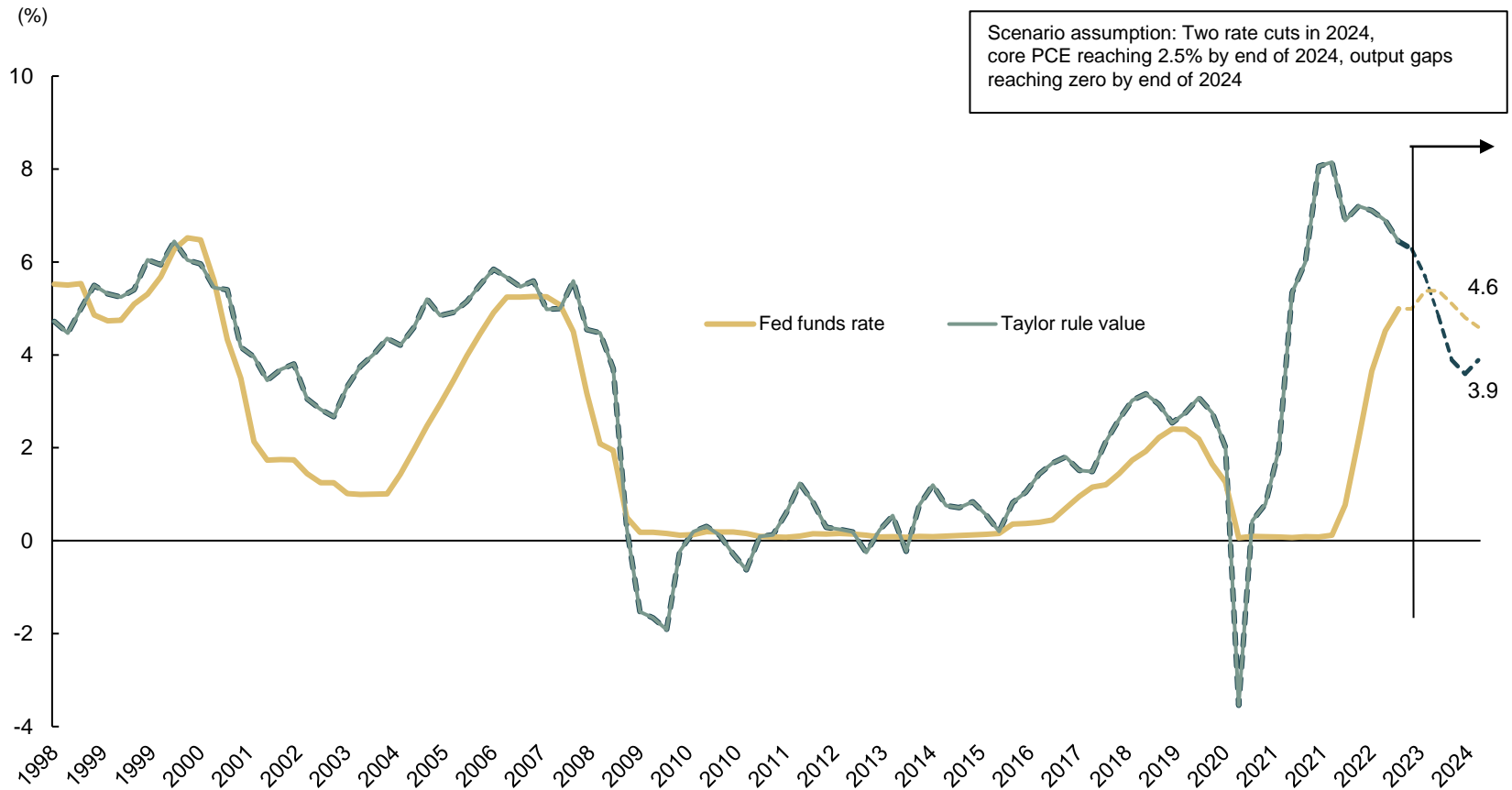
## FOMC Participants' Assessments of Appropriate Monetary Policy



# Hawkish Message of Higher for Longer (continued)

- The federal funds rate is projected to finally exceed the estimated level of the Taylor rule value, justifying no future rate hike unless upside risks of inflation materialize.

## Federal Funds Rate and Taylor Rule Value



# SMBC Economy and Rates Forecast

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
U.S.	Real GDP (saar)	-0.6	3.2	2.6	2.0	2.1	2.5	1.2	0.6	1.0	1.2	1.7	6.0	2.1	2.1	1.2
	Inflation rate (YoY)	5.0	5.0	4.8	4.7	4.4	4.0	3.6	3.0	2.7	2.6	2.5	3.3	5.0	4.2	2.7
	Jobless rate	3.6	3.6	3.6	3.5	3.6	3.4	3.6	3.9	4.1	4.2	4.3	5.4	3.7	3.5	4.1
Euro area	Real GDP (qoq)	0.8	0.4	-0.1	0.0	0.3	0.2	0.1	0.2	0.3	0.3	0.2	5.3	3.3	0.6	0.9
	Inflation rate (YoY)	8.0	9.3	10.0	8.0	6.2	4.8	3.2	3.1	2.9	2.7	2.5	2.6	8.4	5.6	2.8
	Jobless rate	6.7	6.7	6.7	6.6	6.6	6.6	6.7	6.8	6.8	6.9	6.9	7.7	6.7	6.6	6.9
Japan	Real GDP (saar)	5.6	-1.5	0.2	3.7	6.0	0.9	0.9	0.9	0.9	1.1	0.7	2.3	1.1	1.0	0.9
	Inflation rate (YoY)	2.1	2.7	3.8	3.5	3.2	3.0	2.5	3.0	2.8	2.5	2.1	-0.2	2.3	3.1	2.6
	Jobless rate	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP (YoY)	0.4	3.9	2.9	4.5	6.3	4.8	5.5	4.5	5.0	5.1	5.1	8.4	3.0	5.3	4.9
	Inflation rate (YoY)	2.2	2.8	1.8	1.3	0.2	0.0	0.6	1.1	1.5	1.8	2.0	0.8	1.7	0.5	1.6
	Jobless rate	5.8	5.4	5.6	5.5	5.2	5.3	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Rates		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
U.S.	FF target range	4.25	4.75	5.00	5.25	5.25	5.25	5.00	5.00	4.75	4.25	5.25	4.75
		~	~	~	~	~	~	~	~	~	~	~	~
	2yr UST	4.50	5.00	5.25	5.50	5.50	5.00	5.25	5.25	5.00	4.50	5.50	5.00
	10yr UST	3.87	3.47	3.84	4.50	4.20	4.00	3.90	4.00	4.00	3.87	4.20	4.00
Germany	ECB refi rate	2.50	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	2.50	4.25	3.75
	ECB depo rate	2.00	3.00	3.50	3.75	3.75	3.75	3.75	3.50	3.25	2.00	3.50	3.25
	2yr Schatz	2.50	2.68	3.20	3.20	3.00	2.80	2.50	2.40	2.30	2.50	3.00	2.30
	10yr Bunds	2.20	2.29	2.39	2.30	2.30	2.30	2.20	2.10	2.10	2.20	2.30	2.10
Japan	IOER	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.10	0.10	0.10	-0.10	-0.10	0.10
	2yr JGB	0.04	-0.06	-0.07	0.10	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr JGB	0.42	0.35	0.40	0.65	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.50	2.40	2.40	2.40	2.40	2.40	2.75	2.55	2.40
	2yr gov bond	2.39	2.41	2.11	2.05	2.00	2.08	2.15	2.25	2.35	2.39	2.00	2.35
	10yr gov bond	2.83	2.85	2.64	2.64	2.69	2.74	2.79	2.84	2.89	2.83	2.45	2.65

Source: SMBC

# SMBC FX Forecast

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	137.25 ~ 152.00	133.00 ~ 147.00	131.00 ~ 145.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 130.00	113.47 ~ 151.95	127.23 ~ 152.00	126.00 ~ 145.00
		End of period	133.00	132.86	144.31	145.00	140.00	138.00	133.00	135.00	135.00	131.12	140.00
	EUR/USD	0.9633 ~ 1.0735	1.0484 ~ 1.1033	1.0635 ~ 1.1095	1.0300 ~ 1.1300	1.0200 ~ 1.1200	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	0.9536 ~ 1.1495	1.0200 ~ 1.1300	1.0000 ~ 1.1100
EUR/USD	End of period	1.0705	1.0839	1.0909	1.0700	1.0600	1.0500	1.0500	1.0600	1.0600	1.0705	1.0600	1.0600
USD/CAD	Range	1.3275 ~ 1.3885	1.3291 ~ 1.3832	1.3151 ~ 1.3642	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.3000 ~ 1.4200	1.2800 ~ 1.4000	1.2700 ~ 1.3800	1.2477 ~ 1.3885	1.3000 ~ 1.4200	1.2700 ~ 1.4200
		End of period	1.3554	1.3516	1.3242	1.3500	1.3600	1.3500	1.3500	1.3400	1.3300	1.3554	1.3600
	CAD/JPY	96.76 ~ 109.11	95.13 ~ 100.59	97.54 ~ 109.21	101.00 ~ 113.00	97.00 ~ 109.00	96.00 ~ 108.00	92.00 ~ 104.00	94.00 ~ 107.00	94.00 ~ 107.00	89.77 ~ 110.06	95.13 ~ 113.00	92.00 ~ 108.00
CAD/JPY	End of period	96.76	98.28	109.04	107.40	103.00	102.20	98.50	100.75	101.50	96.76	97.80	92.48
EUR/JPY	Range	138.81 ~ 148.40	138.19 ~ 145.67	143.12 ~ 157.92	149.00 ~ 163.00	144.00 ~ 158.00	138.00 ~ 152.00	133.00 ~ 147.00	136.00 ~ 150.00	136.00 ~ 150.00	124.40 ~ 148.40	137.39 ~ 163.00	133.00 ~ 152.00
		End of period	140.41	144.01	157.43	155.15	148.40	144.90	139.65	143.10	143.10	140.41	148.40
	Oil price (WTI futures)	82.64	75.99	73.67	80.00	82.00	82.00	76.00	77.00	78.00	98.74	77.92	78.25

Source: SMBC