



## February FOMC Meeting

### Job growth still robust, but inflation has slowed; Fed tightening nearing an end

#### Key message

As expected, the Fed announced a rate hike of 25bps at the February FOMC meeting, pushing up the policy rate to 4.50-4.75%. The post-meeting statement implies that tightening is nearing an end with a dovish tilt. The biggest difference between the Fed's and the market's projections is whether there will be a rate cut in 2H23. The market predicts a 50bps rate reduction amid an economic recession, while the Fed is economy and inflation data-dependent. All considered, we expect the US economy to head into moderate recession in 2H23F, but core PCE inflation is unlikely to be low enough for the Fed to cut interest rates again, given a slowdown in the commodities inflation downtrend and a moderate fall in services inflation, leading the Fed to start cutting rates in 2024. Only with a severe systemic risk will the Fed consider a rate cut in 2023.

#### Fed thinks inflation has peaked; pace of tightening will gradually slow; time to discuss end of rate hikes

As expected, the US Federal Reserve (Fed) announced a rate hike of 25bps at the February FOMC meeting, pushing up the range of the policy rate to 4.50-4.75%.

In the post-meeting statement, the Fed again mentioned modest economic growth as well as still-robust job gains as suggested by recent expenditure and production data (Figure 1). However, two key points announced in regard to inflation and future rate hike plans differ from the December statement: (1) the Fed again emphasized persistently elevated inflation, but added that inflation has eased somewhat (Figure 2); and (2) in determining the extent of future increases in the target range, the Fed 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. These two changes indicate the Fed's view that inflation has peaked, the pace of tightening has gradually slowed, and that it is time to discuss concluding rate hikes. Overall, the post-meeting statement implies that tightening is nearing an end with a dovish tilt.

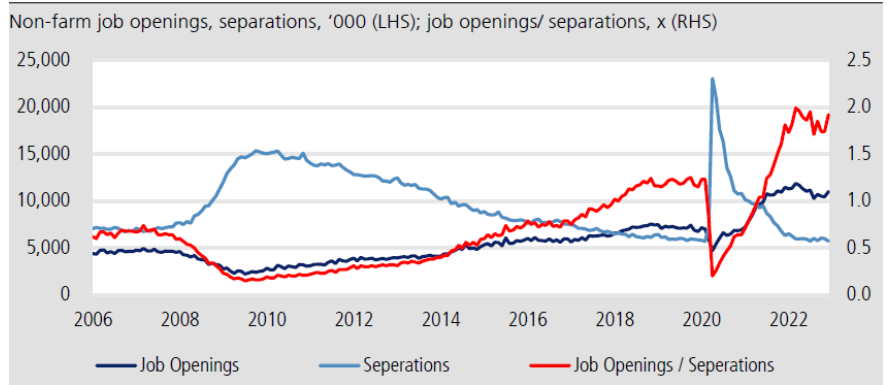
Fed Chair Powell sounded more hawkish at the press conference than the post-meeting statement, but he was not very hawkish about tightening financial conditions, as he highlighted: (1) despite a pretty low core PCE inflation over the past three months (October-December), the labor market remains extremely tight, and the Fed is not confident that inflation is on a sustained downward path, especially as core services inflation has yet to see a significant reduction; (2) the FOMC again discussed how many rate increases are sufficiently restrictive but did not discuss resuming hikes after a pause; and (3) the Fed is focused on sustained changes to financial conditions and there is still work to do on tightening financial conditions, but time and patience are needed (Figure 3).

#### We believe inflation is gradually easing, pointing to an end of Fed's tightening

While Powell hinted at a couple more rate hikes coming (the December dot plot shows two more hikes of 25bps each), we will have January-March inflation data ready at the May FOMC meeting after another 25bps rate increase at the March meeting. It is very likely that core PCE inflation will decline for six consecutive months after steep falls of commodity prices drove down November-December 2022 readings. As such, the possibility of a pause at the May FOMC meeting is pretty high. Currently, the futures market indicates a less than 25% chance of another rate hike in 2Q23 (Figure 5), and forward guidance for a pause will be clearer in the March FOMC dot plot and economic projections.

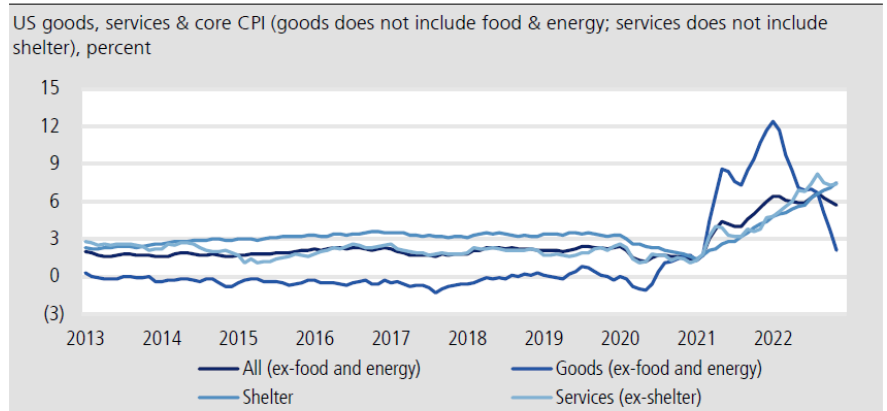
The biggest difference between the Fed's and the market's current projections is whether there will be a rate cut in 2H23. The market predicts a 50bps rate reduction amid an economic recession (Figure 6), while the Fed is economy and inflation data-dependent. All considered, we expect the US economy to head into moderate recession in 2H23F, but core PCE inflation is unlikely to be low enough for the Fed to cut interest rates again, given a slowdown in the commodities inflation downtrend and a moderate fall in services inflation, leading the Fed to start cutting rates in 2024. Only with a severe systemic risk will the Fed consider a rate cut in 2023. The divergence of the market's rate cut expectations in 2H23 from the Fed's will not close until 2H23. As the Fed is not especially focused on the insufficient tightening of financial conditions, which differs from market expectations, the financial markets will continue to reflect a slowdown in the tightening pace and the tightening cycle nearing an end near term.

**Figure 1: A rise in non-farm job openings mainly reflects a surge in shelter & F&B services job openings, implying a still-robust job market**



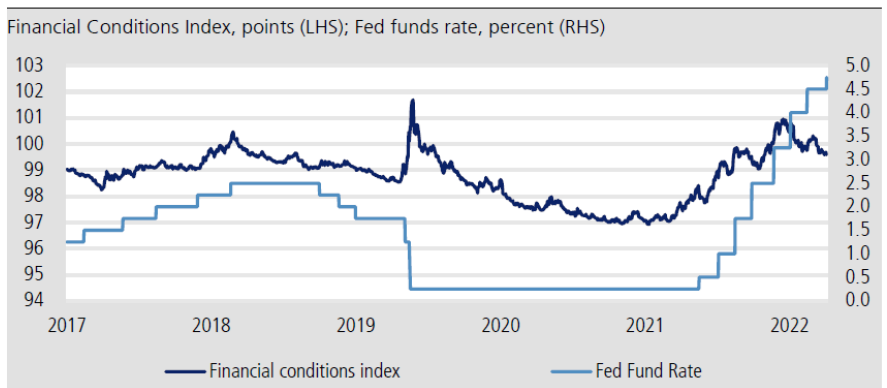
Source: Bloomberg; KGI Research

**Figure 2 : Recent declines in ex-shelter service inflation are unsustainable, according to the Fed, mainly as wages remain high**



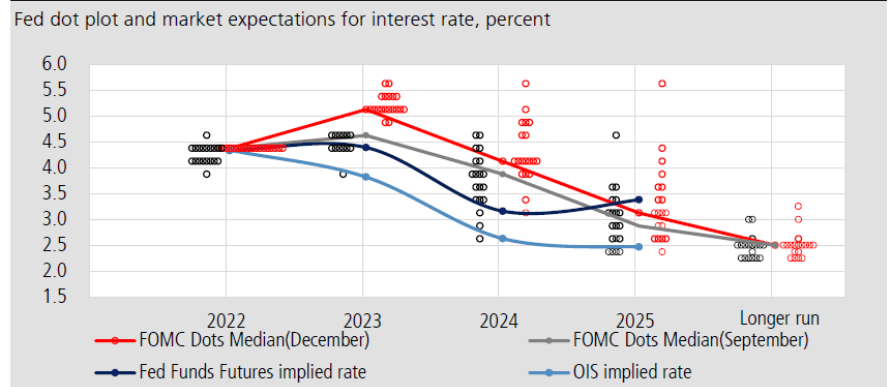
Source: Bloomberg; KGI Research

**Figure 3: Currently, tightening of financial conditions is insufficient, Fed says there is still work to do**

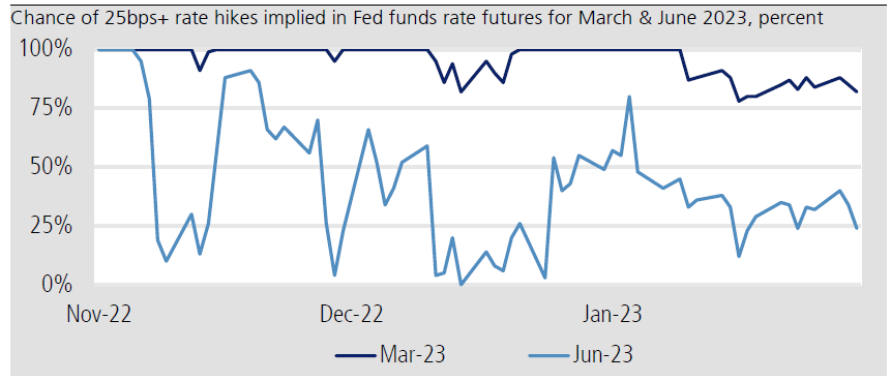


Source: Bloomberg; KGI Research

**Figure 4: December dot plot shows the terminal policy rate at 5.00-5.25%**



**Figure 5: Futures market indicates a less than 25% chance of another hike in 2Q23**



**Figure 6: Market predicts a 50bps rate reduction amid economic recession in 2H23F**

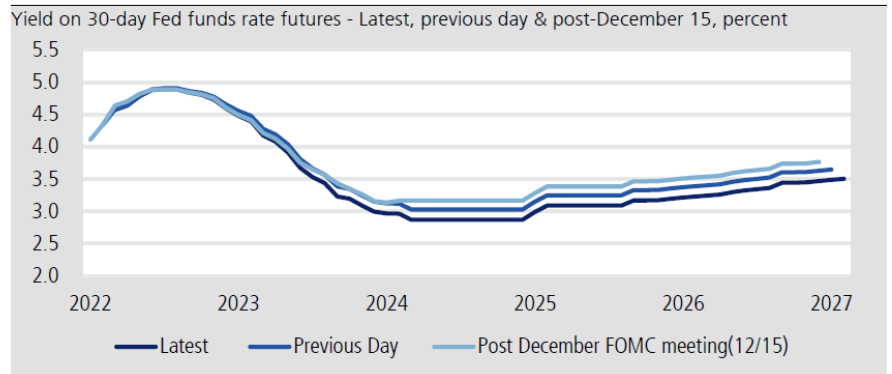


Figure 7: Key US economic data

Indicators	Units	2020	2021	2022	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	
GDP	GDP QoQ SAAR	QoQ % SAAR				(1.6)			(0.6)			3.2				2.9	
	GDP YoY	YoY %	(2.8)	5.9	2.1		3.7			1.8		1.9				1.0	
Consumer prices	CPI	YoY %	1.2	4.7	8.0	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5	
	Core CPI	YoY %	1.7	3.6	6.2	6.4	6.5	6.2	6.0	5.9	5.9	6.3	6.6	6.3	6.0	5.7	
	PCE price index	YoY %	1.1	4.0	6.2	6.4	6.8	6.4	6.5	7.0	6.4	6.3	6.3	6.1	5.5	5.0	
	Core PCE index	YoY %	1.3	3.5	5.0	5.4	5.4	5.0	4.9	5.0	4.7	4.9	5.2	5.1	4.7	4.4	
Labor market	Labor force participation rate	%	61.5	62.0	62.3	62.2	62.4	62.2	62.3	62.2	62.1	62.3	62.3	62.2	62.2	62.3	
	Unemployment rate	%	8.1	5.4	3.6	3.8	3.6	3.6	3.6	3.6	3.5	3.7	3.5	3.7	3.6	3.5	
	Non farm payrolls	'000	(9,292)	6,743	4,503	714	398	368	386	293	537	292	269	263	256	223	
	Net Change In total employment in labor force	'000	(8,873)	6,120	4,503	468	738	(346)	317	(242)	215	422	156	(257)	(66)	717	
	Challenger job cut announce	YoY %	15.8	(1.2)	(1.7)	(56)	(30)	6	(16)	59	36	30	68	48	417	129	
	Opening/ hiring	x	1.07	1.55	1.74	1.66	1.78	1.79	1.74	1.71	1.79	1.62	1.75	1.72	1.73	1.79	
	Aug. hourly earnings	YoY %	5.5	4.9	4.6	5.2	5.6	5.5	5.3	5.2	5.2	5.2	5.1	4.8	4.8	4.6	
Economic activity & business condition	Industrial production	YoY %	(7.0)	4.9	3.9	6.9	4.8	5.3	4.4	3.8	3.6	3.6	5.0	3.4	2.2	1.7	
	Durable goods orders	YoY %	(4.5)	15.6	10.5	10.3	9.8	10.1	12.2	11.9	9.1	11.3	11.5	10.5	6.3	11.1	
	Core capital goods orders	YoY %	(7.8)	12.4	8.3	11.5	10.6	6.4	11.2	9.4	7.3	9.8	8.0	6.4	5.2	3.3	
	Total business inventory/ sales ratio	x	1.44	1.28		1.27	1.28	1.29	1.30	1.30	1.32	1.33	1.33	1.33	1.35		
	Manufacturing inventory/ sales ratio	x	1.61	1.51		1.48	1.47	1.47	1.46	1.46	1.47	1.46	1.45	1.46	1.47		
	Retail inventory/ sales ratio	x	1.34	1.13		1.15	1.18	1.18	1.20	1.21	1.23	1.24	1.24	1.22	1.24		
	ISM manufacturing index	Point	52.4	60.7	53.5	58.4	57.0	55.9	56.1	53.1	52.7	52.9	51.0	50.0	49.0	48.4	47.4
	ISM non-manufacturing index	Point	54.3	62.4	56.1	57.2	58.4	57.5	56.4	56.0	56.4	56.1	55.9	54.5	55.5	49.2	
	ISM manufacturing index: new orders	Point	53.9	64.3	51.6	61.2	54.3	53.8	54.9	50.0	48.6	50.4	47.3	48.2	46.8	45.1	42.5
	Chicago Fed National activity Index	Point	(0.48)	0.36	0.02	0.50	0.19	0.21	(0.25)	(0.34)	0.24	0.18	0.07	0.00	(0.51)	(0.49)	
	Conference board leading index	YoY %	(4.6)	6.6	0.9	7.0	6.0	4.4	2.8	1.3	(0.3)	(1.1)	(1.6)	(3.2)	(4.5)	(6.0)	
C&I Loans for large/medium - tightening lending standard	%	37.6	(15.1)	11.8			(1.5)			24.2			39.1				
C&I Loans for large/medium - stronger demand	%	(15.5)	(1.2)	12.4			12.3			24.2			(8.8)				
Housing market	Building Permits	'000, SAAR	1,476	1,737	1,649	1,857	1,879	1,823	1,695	1,696	1,685	1,542	1,564	1,512	1,351	1,337	
	Housing starts	'000, SAAR	1,395	1,605	1,555	1,777	1,716	1,805	1,562	1,575	1,377	1,508	1,465	1,426	1,401	1,382	
	New home sales	'000, SAAR	831	769	642	790	707	619	636	571	543	646	550	598	602	616	
	Existing home sales	mn, SAAR	5.6	6.1	5.1	5.9	5.8	5.6	5.4	5.1	4.8	4.8	4.7	4.4	4.1	4.0	
	NAHB housing market index	Point, SA	70	81	59	81	79	77	69	67	55	49	46	38	33	31	35
	S&P/Case-Shiller 20-city composite home price index	YoY %	10.2	18.5		20.3	21.2	21.2	20.5	18.6	16.0	13.1	10.4	8.7	6.8		
Consumption	Personal expenditures	YoY % SA	(3.0)	8.3	2.8	6.7	2.3	2.4	2.6	2.1	2.2	2.3	2.1	1.8	1.7	2.2	
	Retail sales	YoY %	0.6	19.8	9.2	17.7	7.1	7.8	8.7	8.8	10.0	9.7	8.4	8.0	6.0	6.0	
	Retail sales ex-autos	YoY %	1.3	19.1	10.6	17.7	9.5	10.5	12.0	11.0	12.1	10.3	9.1	8.6	7.2	7.0	
	Domestic vehicles sales	mn, SA	173.0	179.2	164.8	14.1	13.3	14.3	12.7	13.0	13.4	13.2	13.5	14.9	14.1	13.3	15.7
	Conference board consumer confidence	Point	101.0	112.7	104.5	105.7	107.6	108.6	103.2	98.4	95.3	103.6	107.8	102.2	101.4	109.0	107.1
	Michigan Consumer Sentiment Index	Point	81.5	77.6	59.0	62.8	59.4	65.2	58.4	50.0	51.5	58.2	58.6	59.9	56.8	59.7	64.9
Fiscal	Budget balance	As % of GDP	(15.6)	(10.8)	(5.5)	(9.2)	(7.2)	(4.9)	(4.7)	(4.3)	(3.2)	(3.7)	(5.4)	(4.3)	(5.3)	(5.5)	
	Current account balance	As % of GDP	(2.9)	(3.6)			(3.8)			(3.9)			(3.7)				
Int'l balance	Net foreign securities transactions	US \$bn	505	907		145.0	23.7	87.6	155.3	121.8	21.3	198.3	117.7	67.8	171.5		
	Federal funds rate	%	0.25	0.25	4.50	0.25	0.50	0.50	1.00	1.75	2.50	2.50	3.25	3.25	4.00	4.50	
Monetary & financial	10-Year treasury yield	%	0.91	1.51	3.87	1.83	2.34	2.93	2.84	3.01	2.65	3.19	3.83	4.05	3.61	3.87	3.51
	Dollar index	Point	89.9	95.7	103.5	96.7	98.3	103.0	101.8	104.7	105.9	108.7	112.1	111.5	106.0	103.5	102.1

Source: Bloomberg; KGI Research

Figure 8: Key Taiwan economic data

Indicators	Units	2020	2021	2022	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	
GDP	GDP YoY	YoY %	3.4	6.5	2.4		3.9			3.0		4.0				(0.9)	
Consumer prices	CPI	YoY %	(0.2)	2.0	3.0	2.3	3.3	3.4	3.4	3.6	3.4	2.7	2.8	2.7	2.4	2.7	
	Core CPI	YoY %	0.7	1.8	2.7	1.6	2.5	2.5	2.6	2.8	2.7	2.7	2.8	3.0	2.9	2.7	
Labor market	Unemployment rate	%	3.7	3.7	3.6	3.7	3.7	3.7	3.7	3.7	3.7	3.6	3.6	3.6	3.6	3.6	
Economic activity	Industrial production	YoY %	7.1	13.4	0.9	9.5	2.4	6.4	4.1	0.5	1.6	3.3	(4.5)	(4.3)	(5.6)	(7.9)	
	Markit Taiwan manufacturing PMI	Point		58.5	47.7	54.3	54.1	51.7	50.0	49.8	44.6	42.7	42.2	41.5	41.6	44.6	44.3
	NDC monitoring light signal					Yellow-red	Green	Green	Green	Green	Green	Green	Yellow-blue	Yellow-blue	Blue		
	NDC monitoring indicators	Point	24.3	39.0		34.0	31.0	28.0	28.0	27.0	24.0	23.0	17.0	18.0	12.0		
	NDC composite leading index	YoY %	(0.5)	4.0		5.8	5.5	5.0	4.3	3.3	1.9	0.4	(0.9)	(2.1)	(3.0)		
	NDC composite coincident index	YoY %	(1.1)	4.9		7.8	7.2	6.6	6.1	5.6	4.5	2.7	0.5	(2.1)	(4.8)		
Consumption	Retail sales	YoY %	0.2	3.3	7.4	0.2	5.5	4.7	3.6	22.5	18.1	12.0	7.8	2.1	1.8	9.4	
Trade	Exports	US\$bn	345.2	446.6	479.7	37.5	43.5	41.5	42.1	42.2	43.3	40.3	37.5	39.9	36.1	35.8	
	Imports	US\$bn	285.8	381.3	428.1	31.6	38.9	36.6	39.7	37.6	38.3	37.4	32.5	37.0	32.7	31.0	
	Trade balance	US\$bn	59.4	65.3	51.6	5.8	4.7	4.9	2.4	4.6	5.0	3.0	5.0	3.0	3.4	4.8	
	Export growth	YoY %	4.9	29.4	7.4	34.8	21.3	18.8	12.4	15.2	13.9	1.9	(5.3)	(0.5)	(13.1)	(12.1)	
	Import growth	YoY %	0.1	33.4	12.3	35.2	19.4	26.7	26.6	19.1	19.1	3.4	(2.6)	8.2	(8.6)	(11.4)	
	Export orders	US\$bn	533.7	674.1	666.8	51.6	62.7	51.9	55.4	58.8	54.3	54.6	60.9	55.4	50.1	52.2	
	Export order growth	YoY %	10.1	26.3	(1.1)	21.1	16.8	(5.5)	6.0	9.5	(1.9)	2.0	(3.1)	(6.3)	(23.5)	(23.2)	
Monetary & financial	M1B	YoY %	16.2	12.8	4.1	11.1	10.9	9.8	8.5	8.1	6.7	7.6	6.6	5.2	4.4	4.1	
	M2	YoY %	8.5	8.0	7.1	7.7	8.1	8.1	7.9	7.7	7.0	6.9	6.8	7.3	7.4	7.1	
	Foreign reserves	US\$bn	529.9	548.4	554.9	550.0	548.8	545.1	548.9	549.0	547.8	545.5	541.1	542.8	552.2	554.9	
	Rediscount rate	%	1.1	1.1	1.8	1.1	1.4	1.4	1.4	1.5	1.5	1.5	1.6	1.6	1.6	1.8	1.8
	Exchange rate	USD/TWD	28.1	27.7	30.7	28.0	28.6	29.4	29.0	29.7	29.9	30.4	31.8	32.3	30.8	30.7	30.0

Source: Bloomberg; KGI Research

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