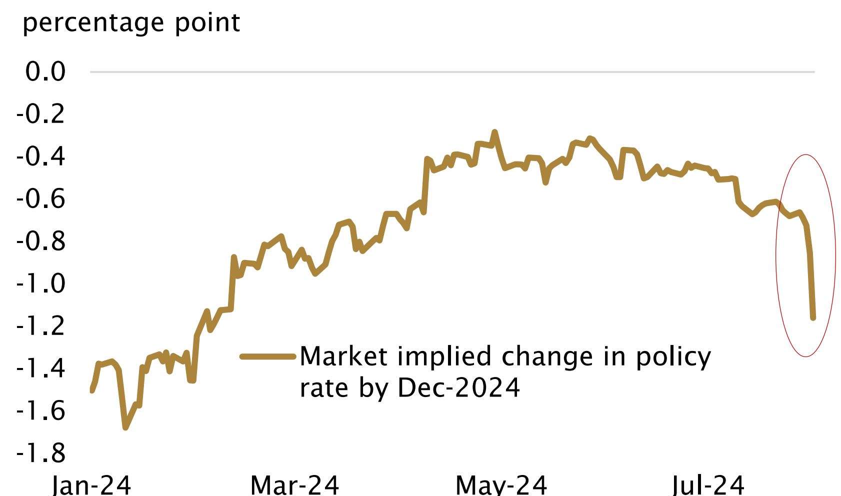
Monetary policy tracker: US Fed FOMC held policy in July; September rate cut on the table

August 4, 2024

Key takeaways

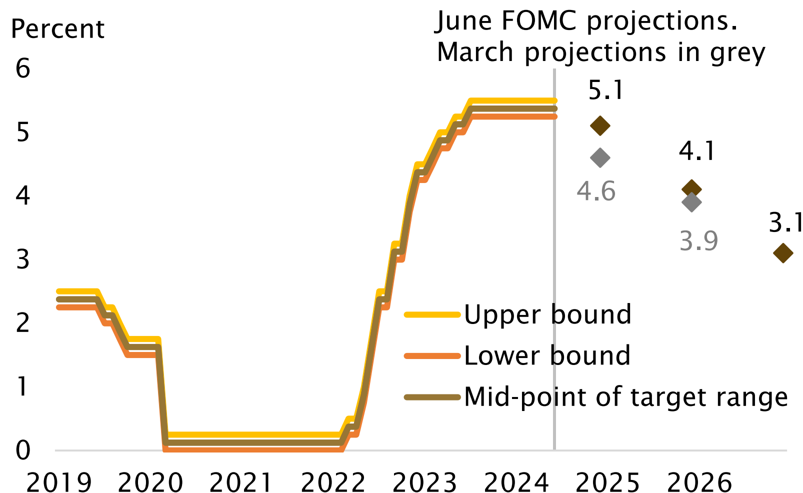
- The week ending August 2, 2024 turned out to be a significant one since the start of policy easing by some of the central banks in advanced economies this year. The US Fed FOMC kept its policy rate unchanged, with the Fed Chair Powell putting September rate cut on the table in the post policy conference. Chair Powell acknowledged that the downside risks to the Fed's employment mandate were real and needed to be accounted for in policy making, a shift away from its earlier sole focus on the inflation target. Within a couple of days post the Fed meeting, weak labor market data spooked financial markets. The unemployment rate rose in July, triggering the Sahm rule, a recession indicator, though as noted by Chair Powell, many such indicators have failed to work in the post-pandemic era. Nonetheless, the data prompted markets, including some banks, to bring forward their rate cut forecasts, and account for steeper and/or more number of cuts.
- The Bank of England delivered a cautious cut of 25bp, bringing its Bank rate to 5% in a narrow 5-4 vote decision. The MPC remained wary of the risks to persistence of inflation in the medium term, but dialed down on policy restriction due to reduced impact from external shocks and normalization in inflation expectations.
- The ECB kept policy rates unchanged in July after delivering 25bp cut in June. In its assessment of the economy, the ECB noted downside risks to growth, contrary to the earlier view of balanced risks in the near term However, actual GDP data surprised on the upside, growing at the same rate quarter-on-quarter as Q1. In July, headline and core inflation were higher than market expectations.
- In a surprise policy move, the Bank of Japan raised its benchmark rate to 0.25% from 0-0.1% at its monetary policy meeting held on July 31. The BoJ also provided forward guidance, suggesting further hikes if the economic activity and inflation evolved as per its expectations. Most market participants had expected the BoJ to hold policy after it ended an eight-year long negative interest rate regime by hiking rate for the first time in 17 years in March.
- The PBoC cut major policy rates in July to support the real economy that grew at a slower-than-expected pace in Q2. The easing also marked a shift in the benchmark rate to the short-term one, compared to the medium-term rate used earlier.



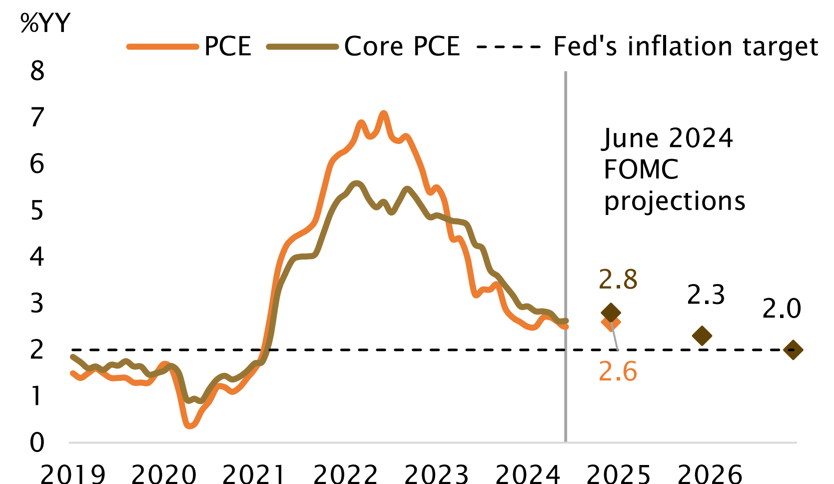
US Fed FOMC held policy in July; September rate cut on the table

- At its policy meeting concluded on July 31, the Fed FOMC held target range for the policy rate at 5.25-5.50 percent for the eighth successive meeting. The last time the Fed hiked was in July 2023. In the policy statement, the FOMC noted "some further progress" in disinflation, while emphasizing its dual mandate of maximum employment and price stability, a shift from its earlier focus solely on the inflation objective.
- In the opening statement prior to the post-policy conference, the Fed Chair noted that Q2 data had added to the FOMC's confidence of inflation sustainably moving towards 2%, and that labor market conditions were coming into better balance amid continued strength in economic activity. However, in response to queries in the conference, Chair Powell noted that while the labor market was normalizing, downside risks to its employment mandate were real and would need to be weighed along with risks to the inflation target. If upcoming data remained in line with expectations, the Fed could start dialing back on policy restriction by starting to cut as early as the September meeting, though further policy path would remain data dependent.
- Private final domestic purchases, the Fed FOMC's preferred measure of domestic demand, remained firm at 2.6%YY in H1-2024. In Q2, core PCE inflation eased to 2.7% from 2.9% in Q1, and employment cost index rose at a softer pace in Q2 than in Q1. However, the latest labor market data for July, released within days after the Fed FOMC decision, was weaker-than-expected and triggered the Sahm rule, a recession indicator. This prompted many foreign banks to account for earlier, steeper or more number of rate cuts.

Target range for Federal Funds rate held since July 2023



Core PCE averaged 2.7% in Q2, lower than 2.9% in Q1



US labor market data triggered Sahm rule, a recession indicator

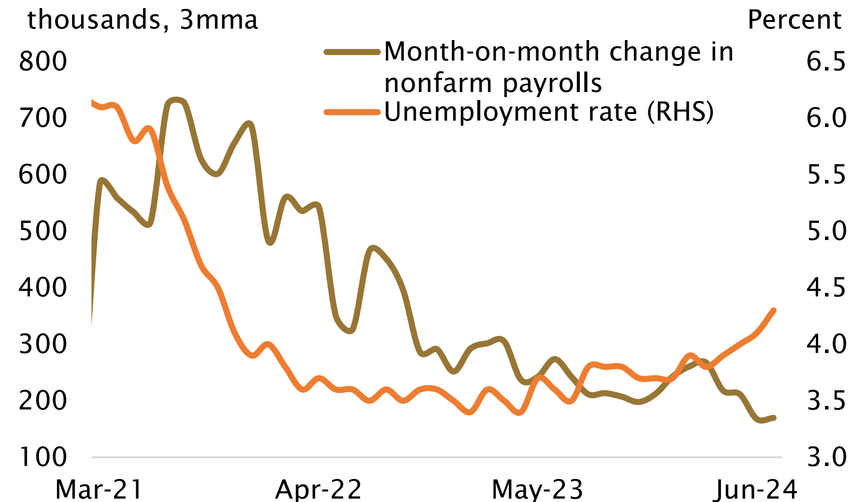
- According to the Sahm rule, developed by former Fed economist Claudia Sahm, a recession is underway when the three-month moving average of the unemployment rate exceeds the 12-month low by half percentage point. The unemployment rate rose from 4.1% in June to 4.3% in July, the highest since November 2021. Non-farm payroll additions were at muted at 114,000; less than Bloomberg estimate of 175,000.

- The US Fed Chair, while responding to a query on the Sahm's rule in the post-policy conference, noted that the rule was a statistical regularity and in the post-pandemic era, many rules, including the ones such as the inverted yield curve had not worked.

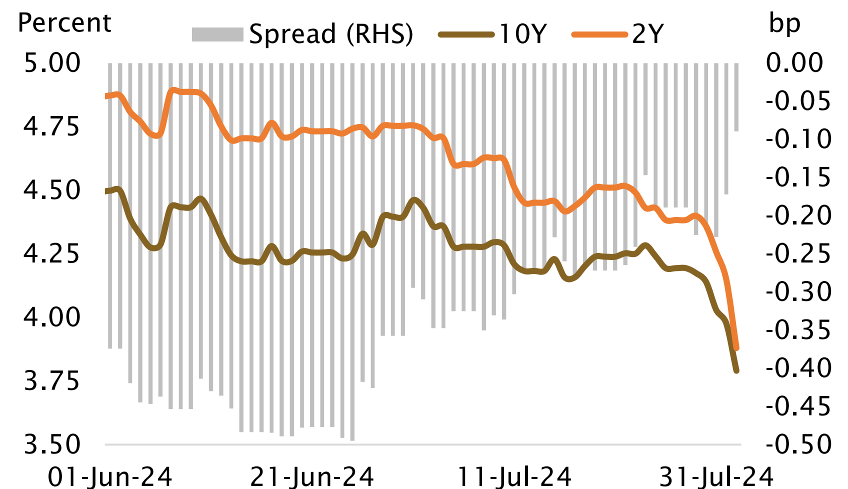
- Following labor market data, yields fell across the curve, with the 2-year yield slipping below 4% for the first time since May 2023. The 10-year benchmark also slid below 4%, with the negative yield differential between the two narrowing sharply.

- The next Fed policy outcome is due on September 18. Based on futures data, market is currently pricing more than one percentage point of rate cuts by year-end, with a reasonable probability of 50bp cut at the September meeting.

Weaker-than-expected labor market data in July



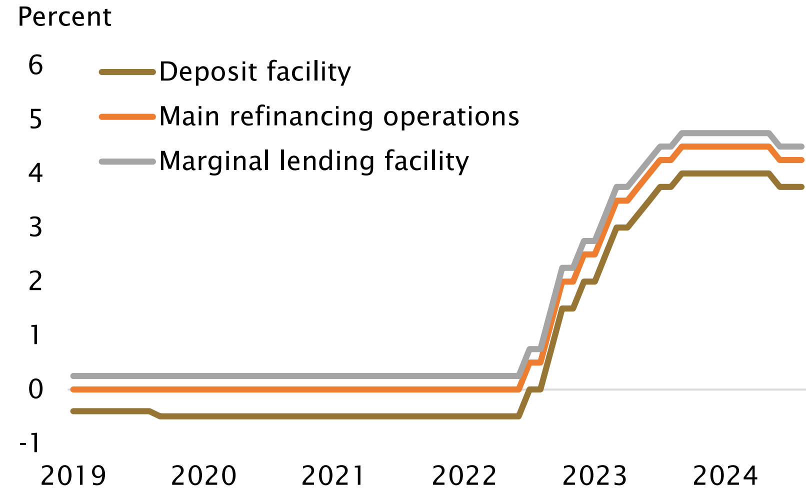
Yields fell across the curve following weak employment data



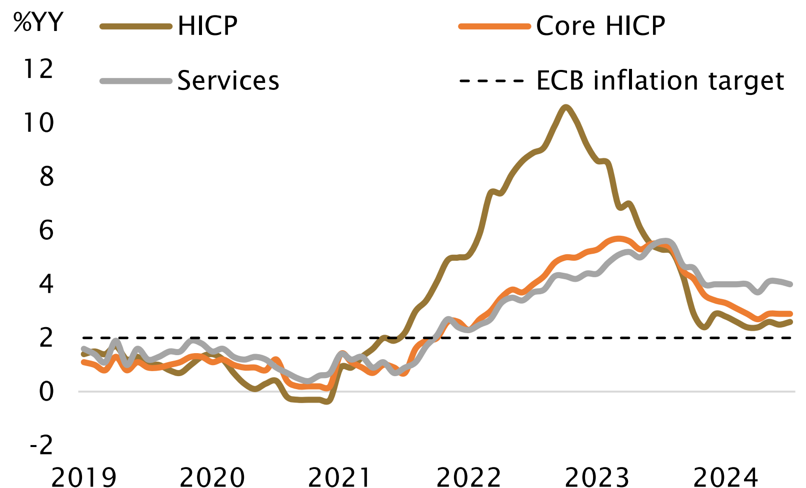
ECB held policy at July meeting; noted downside risks to growth

- In its latest policy meeting outcome on July 18, the ECB's governing council kept key policy rates unchanged after lowering them each by 25 bps in June. Accordingly, rates on refinancing operations, marginal lending facility and deposit facility were held at 4.25%, 4.50% and 3.75% respectively. The ECB reiterated that it will remain data dependent to determine level and duration of policy restriction.
- In its assessment of the economy, the ECB noted downside risks to growth, contrary to the earlier view of balanced risks in the near term amid expectations of lower growth in Q2 compared to Q1. However, actual GDP data surprised on the upside, growing at the same rate quarter-on-quarter as Q1.
- The ECB expects inflation to ease towards its 2% target only in H2-2025. In July, both headline and core inflation were higher than market expectations. Services inflation eased, albeit marginally, and remained elevated relative to overall inflation.
- The unemployment rate rose slightly to 6.5% in June from 6.4% in May, thwarting the ECB's expectation of a consumption-led recovery. The latest manufacturing PMI survey casts a gloomy outlook to the start of Q3, with net employment falling further in July and output sub-index at a seven month low. Input prices rose at the fastest rate in a year-and-a-half, while output charges were unchanged, as companies refrained from passing on higher costs.
- The next ECB policy decision is due on September 12. Market is currently pricing one 25bp rate cut in September and another 25bp one in December.

ECB held policy rates in July after easing in June



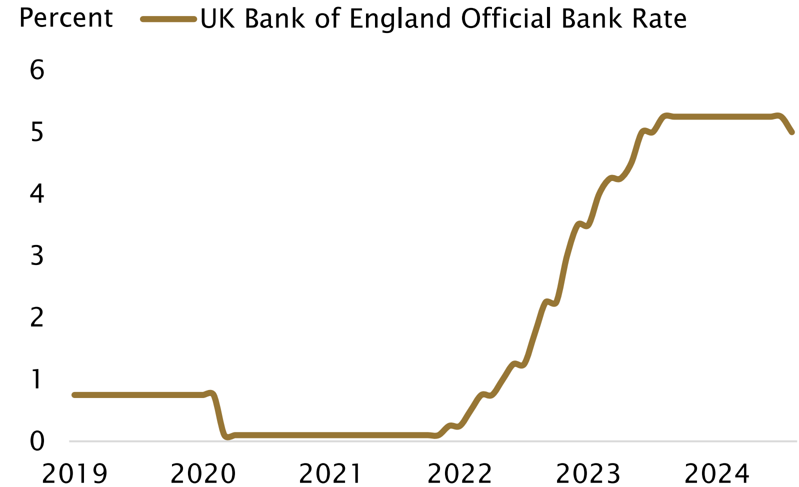
Inflation surprised on upside in July



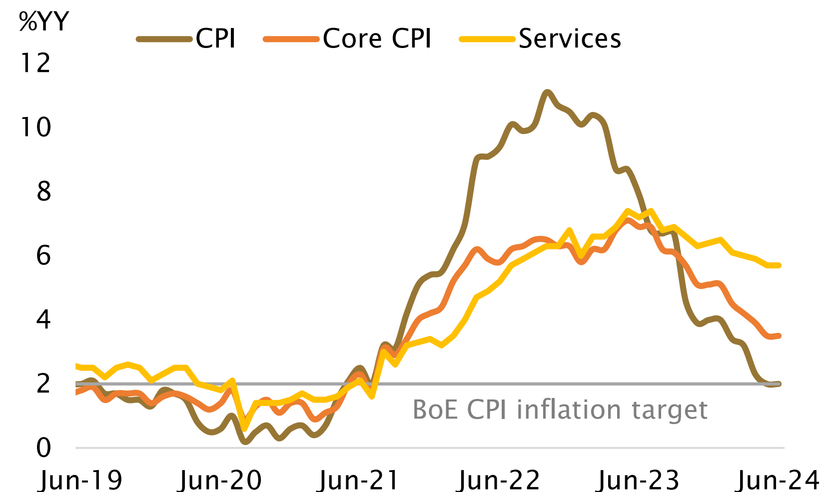
BoE delivered a cautious cut of 25bp in a narrow vote decision

- At its monetary policy meeting decision on August 1, the Bank of England's Monetary Policy Committee (MPC) reduced the Bank rate by 25bps to 5% after keeping policy unchanged for six straight meetings since September 2023. The outcome was supported by a narrow majority with five out of nine members in favor of the cut, with four preferring to hold.
- The MPC preferred to not commit to a policy path and reiterated its commitment to keep policy restrictive for as long as necessary to bring inflation sustainably close to its 2% target. While the headline CPI print stayed at 2%, both in May and June, the MPC expects it to rise to 2.75% in Q4, as favorable effects from low energy prices in 2023 fade from data. Inflation is likely to sustainably remain at or below 2% only from 2026. Also, the MPC raised real GDP outlook for 2024 to 1.2%YY from 0.5% due to strong growth momentum in early part of the year.
- The MPC remained wary of the risks to persistence of inflation in the medium term due to second-round effects. However, the decision to dial down on the degree of restriction was after taking into account the reduced impact from external shocks and normalization in inflation expectations. These are expected to feed through weaker pay and wage-setting dynamics, moderate GDP growth and ease labor market conditions.
- The next BoE MPC decision is due on September 19. Market is currently pricing a strong probability of a 25bp rate cut in November, and a reasonable chance of another 25bp in December.

BoE cut benchmark rate by 25bp to 5% at August meeting



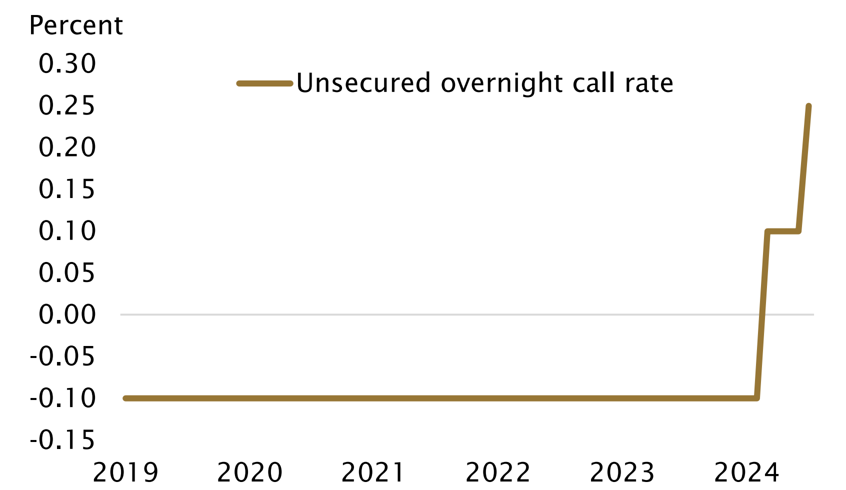
Headline CPI at 2% in May, June; services inflation still high



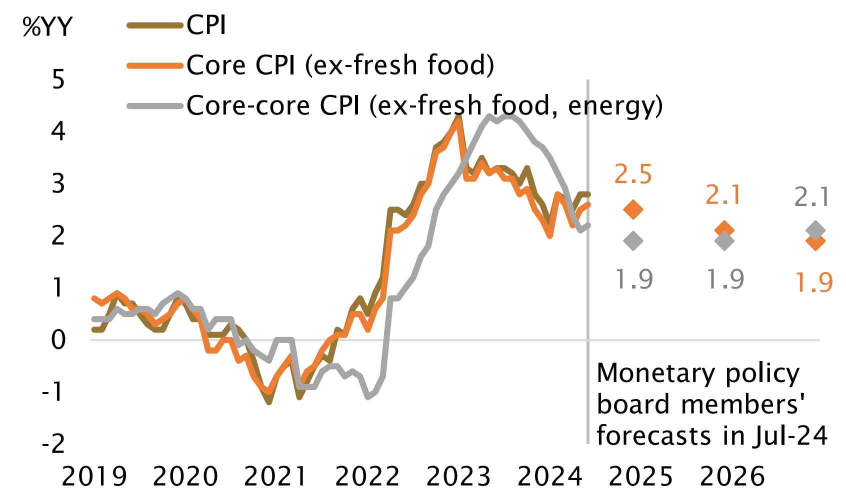
BoJ surprised by hiking policy rate in July to 0.25% from 0-0.1%

- In a surprise policy move, the Policy Board of the Bank of Japan raised the uncollateralized overnight call rate to 0.25 percent from 0-0.1 percent by a 7-2 majority vote at its monetary policy meeting held on July 31. Most market participants expected the Bank to hold the policy rate stable after it ended an eight-year long negative interest rate regime by hiking the rate for the first time in 17 years in March.
- By a unanimous vote, the Board also decided to reduce the amount of monthly purchases of JGBs by almost half to around 3 trillion yen by Q1-2026.
- The Board stated that if the outlook for economic activity and prices evolved as per its expectations, it would continue to raise the policy interest rate.
- In its latest outlook report, the Board members trimmed their forecasts for growth (0.6%YY vs 0.8%) and inflation (2.5% vs 2.8%) for fiscal 2024. Lower GDP forecast accounts for statistical revisions to fiscal 2023 data. The cut in inflation forecast reflects government support to ease households' energy costs that is expected to fade in fiscal 2025.
- Risks to inflation are skewed to the upside in fiscal 2025 and 2026, as wage increases by large firms in this year's annual spring wage negotiations are spreading. This is bolstering the Board's confidence of a virtuous cycle from income to spending, and lending upside risk to this year's growth outlook.
- Headline inflation in June was unchanged from the May at 2.8% amid slight increases in core measures.
- The next BoJ decision is due on September 20, with market now pricing another 15bp hike by December.

BoJ surprised by hiking policy rate in July to 0.25%



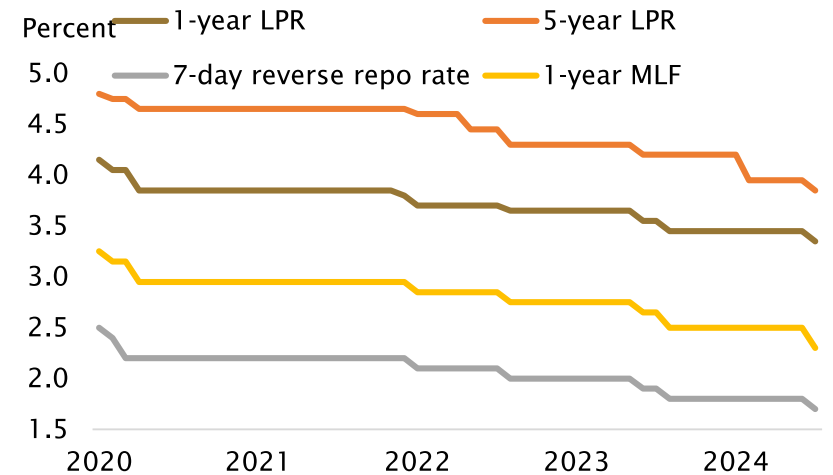
Core CPI expected to moderate to 2% target in 2025



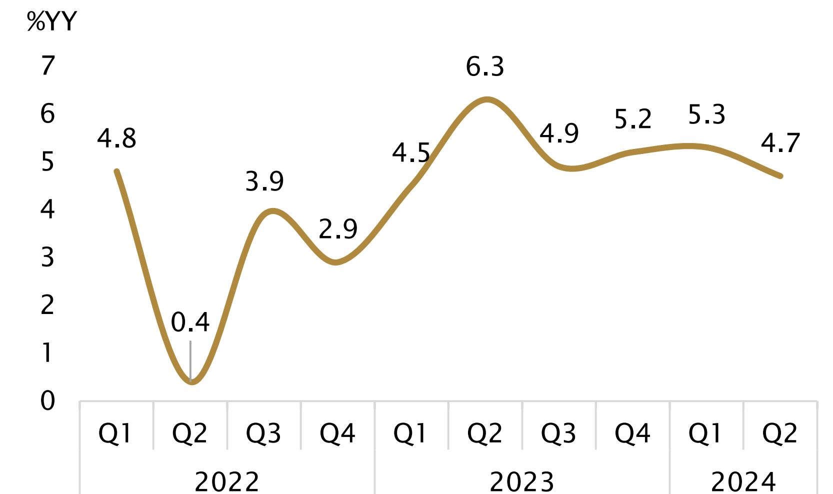
PBoC cut major interest rates in July to support economy

- In what marked a number of surprise moves in July, the PBoC cut major policy rates as an attempt to strengthen counter-cyclical adjustments to support the real economy. On July 22, the PBoC slashed the seven-day reverse repo rate by 10bp to 1.7% from 1.8%, followed by the one-year and five-year loan prime rates that were lowered to 3.35% (from 3.45%) and 3.85% (from 3.95%), respectively.
- These changes come after PBOC Governor Pan Gongsheng's speech in June where he indicated room for improvement in the monetary policy framework. The Governor noted the use of short-term operational rate as the main policy rate, akin to certain other central banks, further adding that "the 7-day reverse repo rate basically fulfills this function". This suggested possibility of the medium-term rate being phased out as the main policy rate. Indeed, within days after lowering the 7-day rate, the PBoC, on July 25, cut the one-year medium-term lending facility rate by 20bps to 2.3% from 2.5%, paving the way for the short-term rate to function as the primary policy rate.
- Earlier in July, the PBoC announced plans to borrow treasury bonds from primary dealers, with a possible intent of selling them to cap the drop in long-term yields. Later in the month, the PBoC also announced lowering collateral requirements for MLF loans. The could enable banks to hold less bonds and instead sell them, which could prop up long term yields.
- In Q2, real GDP surprised on the downside, while CPI inflation remained tepid at 0.3%, albeit marked an improvement after remaining flat in Q1.

7-day reverse repo cut by 10bp, 1-year MLF reduced by 20bp



Lower-than-expected real GDP growth in Q2



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