Global Markets Research

Research Alert

Higher US price prints support higher for longer stance

Higher services and commodity prices prompted acceleration in 1Q PCE

Latest FOMC flagged persistent inflationary concern and pushed back near-term rate cut

We now expect the Fed to begin easing in 4Q; barring a collapse in labour market

Overview

In the latest FOMC statement and recent Fed speaks, officials have largely flagged concerns that there was a lack of further progress towards the 2.0% inflation objective in recent months, not only dampening rate cut outlook but also reignited small chatters on possibility of a rate hike. Fed Chair Jerome Powell nonetheless, downplayed expectations that Fed's next move will be a rate hike, saying that favourable supply factors can keep inflation on the right track. He added that the current stance is "sufficiently restrictive", implying that rate cuts remain on the cards although not in the near term. This reaffirmed our expectation that the Fed has no urgency to cut and would push back the magnitude as well as timing of its easing cycle to the last quarter of the year.

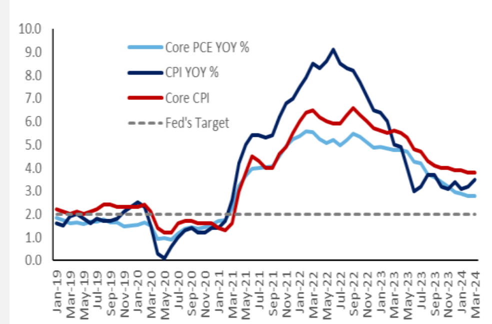
US core PCE-prices has stabilized around a 3-year low of 2.8%, but sticky services inflation has and may drive price prints higher till year end

- With the Fed assessment on the lack of progress towards the 2.0% inflation target (Figure 1) at this juncture and amidst a still tight, albeit less, labour market (Figure 2), **we now expect the Fed to start easing in 4Q, and probably by 25bps for the year.** (Previous estimate: 3Q and 75bps cut in 2024).
- In fact, the latest Fed's preferred inflation gauge reaffirmed the Fed's view, with headline PCE prices accelerating at a faster than expected pace to 2.7% y/y in March (Feb: +2.5% y/y), while core also came above street estimate at +2.8% y/y for the same month.
- Sticky services inflation (driven by healthcare and financial services recently), elevated inflation expectations and generally higher global commodity prices partly due to supply-side factors, like weather-related disruption on food prices as well as geopolitical tensions on oil prices and supply chain disruptions, could potentially drive price prints higher till year end.
- Based on our calculation, every $1/barrel increase in WTI could send US inflation prints up by 0.2ppts m/m for that specific month.
- In reality, the easing trend in inflation has not only stalled, but is reversing. Both headline as well as core PCE prices have accelerated from an average of 0.2% m/m growth in 2H of 2023 to an average of +0.4% m/m in 1Q of 2024.
- Even assuming a conservative 0.2% m/m increase in core prices for the rest of the year, core-PCE is expected to flirt around the 3% level for the rest of the year. This would translate into a 2.8% average increase in core PCE for full year 2024, above Fed's March forecast of 2.6%.
- A more likely 0.3% m/m increase for the rest of 2024 could send core PCE above Powell's "comfortable" level of 3.0% again in July and spiralling towards 3.9% in December 2024. This will bring full year core PCE to average even higher at 3.2% in 2024.

Labour market health a wild card

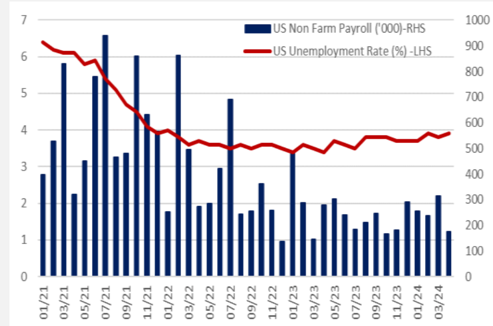
Despite our expectation of sticky price pressures with likelihood of a reacceleration in price prints in the 2H of the year, we are pencilling one rate cut in 4Q largely on account that the impact from the tightened monetary policy may be finally trickling

Figure 1: Disinflation is losing momentum, particularly evident in headline CPI



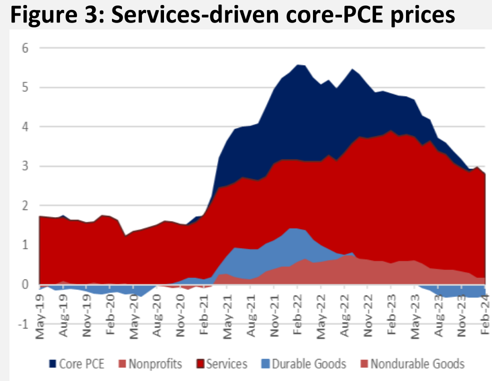
Source: Bloomberg

Figure 2: Still tight labour market



Source: Bloomberg

Figure 3: Services-driven core-PCE prices



Source: Bloomberg

into the labour market. That said, we have not observed any dislocation in the labour force at this juncture although hiring plans have slowed. In addition, gains in non-farm payroll have slowed to +175k in April, but this comes after a very strong March reading of +315k and is still above the recent low of +163k in October 2023.

Conclusion and implications on monetary policy

In short, barring any shocks in prices and dislocations in the labour market, a 0.3% m/m increase in core-PCE for 2024 and +0.1% m/m in 2025 suggests that core-PCE will only moderate again in early 2025 and back below the 3.0% level in 2Q of 2025. With this, we are revising our house view that the first-rate cut will start in 4Q, with a total of 25bps rate cuts expected for 2024.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, March 2024

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2024	2025	2026	Longer run	2024	2025	2026	Longer run	2024	2025	2026	Longer run
Change in real GDP	2.1	2.0	2.0	1.8	2.0–2.4	1.9–2.3	1.8–2.1	1.7–2.0	1.3–2.7	1.7–2.5	1.7–2.5	1.6–2.5
December projection	1.4	1.8	1.9	1.8	1.2–1.7	1.5–2.0	1.8–2.0	1.7–2.0	0.8–2.5	1.4–2.5	1.6–2.5	1.6–2.5
Unemployment rate	4.0	4.1	4.0	4.1	3.9–4.1	3.9–4.2	3.9–4.3	3.8–4.3	3.8–4.5	3.7–4.3	3.7–4.3	3.5–4.3
December projection	4.1	4.1	4.1	4.1	4.0–4.2	4.0–4.2	3.9–4.3	3.8–4.3	3.9–4.5	3.8–4.7	3.8–4.7	3.5–4.3
PCE inflation	2.4	2.2	2.0	2.0	2.3–2.7	2.1–2.2	2.0–2.1	2.0	2.2–2.9	2.0–2.5	2.0–2.3	2.0
December projection	2.4	2.1	2.0	2.0	2.2–2.5	2.0–2.2	2.0	2.0	2.1–2.7	2.0–2.5	2.0–2.3	2.0
Core PCE inflation[4]	2.6	2.2	2.0		2.5–2.8	2.1–2.3	2.0–2.1		2.4–3.0	2.0–2.6	2.0–2.3	
December projection	2.4	2.2	2.0		2.4–2.7	2.0–2.2	2.0–2.1		2.3–3.0	2.0–2.6	2.0–2.3	
Memo: Projected appropriate policy path												
Federal funds rate	4.6	3.9	3.1	2.6	4.6–5.1	3.4–4.1	2.6–3.4	2.5–3.1	4.4–5.4	2.6–5.4	2.4–4.9	2.4–3.8
December projection	4.6	3.6	2.9	2.5	4.4–4.9	3.1–3.9	2.5–3.1	2.5–3.0	3.9–5.4	2.4–5.4	2.4–4.9	2.4–3.8

Source: Federal Reserve

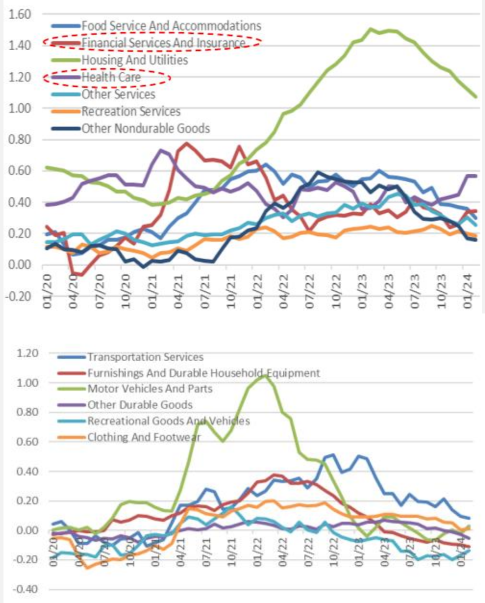
Table 2. House View on Interest Rate and FX Forecasts

FX	This Week	2Q-24	3Q-24	4Q-24	1Q-25
DXY	103-107	105.43	105.56	103.45	101.38
EUR/USD	1.06-1.09	1.06	1.05	1.06	1.06
GBP/USD	1.24-1.27	1.24	1.22	1.23	1.24
USD/JPY	150-156	152	149	146	143
AUD/USD	0.64-0.67	0.65	0.65	0.65	0.66
USD/MYR	4.71-4.78	4.73	4.68	4.64	4.57
USD/SGD	1.34-1.37	1.35	1.35	1.34	1.33

Rates, %	Current	2Q-24	3Q-24	4Q-24	1Q-25
Fed	5.25-5.50	5.25-5.50	5.25-5.50	5.00-5.25	4.50-4.75
ECB	4.50	4.25	3.75	3.50	3.50
BOE	5.25	5.25	4.75	4.50	4.50
BOJ	0 - 0.10	0 - 0.10	0 - 0.10	0 - 0.10	0 - 0.10
RBA	4.35	4.35	4.35	4.10	4.10
BNM	3.00	3.00	3.00	3.00	3.00

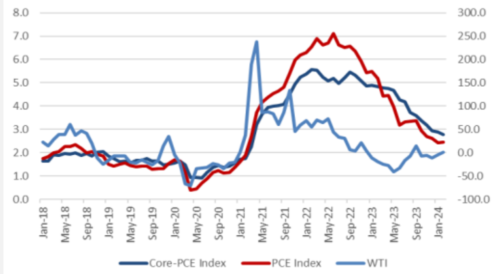
Source: HLBB Global Markets Research

Figure 4: Upticks in selected services subsectors



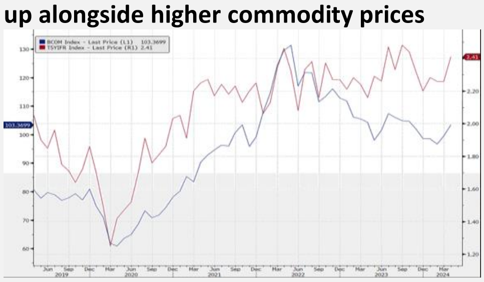
Source: Bloomberg

Figure 5: High correlation between oil and PCE prices



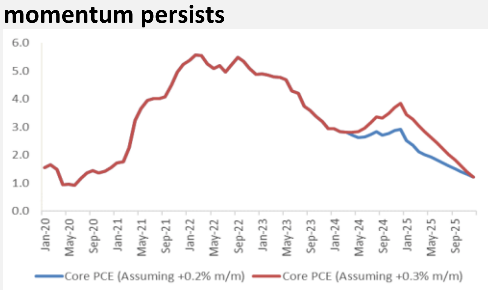
Source: Bloomberg

Figure 6: Inflation expectations have ticked up alongside higher commodity prices



Source: Bloomberg

Figure 7: Core PCE is poised to climb higher again should the current month-on-month momentum persists



Source: Bloomberg

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