UOB Investment Insights

Thinking Ahead

13 June 2024

Key takeaways

- The US Federal Reserve (Fed) kept interest rates unchanged at the June Federal Open Market Committee (FOMC) meeting.
- The Fed wants more evidence of slowing inflation before being confident to cut interest rates.
- We expect two 25 basis points (bps) reductions in September and December.
- Enhance your investment income by complementing investment grade bonds and dividend-paying stocks; diversify your portfolio to capture shifts in market trends.

US interest rates unchanged for a seventh straight meeting

At the June FOMC meeting, the Fed kept interest rates unchanged at a two-decade high of 5.25% - 5.50%. This was the seventh straight meeting where the Fed voted for no policy changes. However, it still signaled the possibility of rate cuts this year.

Key takeaways from June FOMC meeting

1. Fed's updated interest rate projection

- Fed officials now expect only one 25bps rate cut this year, down from the outlook of three 25bps cuts in March.
    - This suggests the Fed believes interest rates need to stay high for a while longer and will only cut rates once they are confident that inflation is slowing towards the 2% target.
- However, Fed officials expect more rate cuts next year, now projecting four 25bps reductions rather than the three previously outlined.
    - Fed officials seem to hold the view that the trend of slowing inflation has been delayed but not derailed.
    - Hence, additional rate cuts that might have taken place this year will instead take place next year.
- The Fed's long-run neutral rate* estimate was raised from 2.6% to 2.8%.
    - This indicates that Fed officials are increasingly open to the idea that current interest rates may not be as restrictive as previously thought, which limits the scope for potential rate cuts in the longer run.
    - Fed Chairman Powell also mentioned that interest rates are less likely to fall towards pre-pandemic levels.

* This is the level of interest rate that neither stimulates nor restricts the economy by itself.

2. **Policy guidance**

   - Fed Chairman Jerome Powell was very careful in calibrating his policy message, leaving all options on the table by saying the central bank is taking a meeting-by-meeting and data-dependent approach.
   - To reflect the slowdown in inflation over April and May, the Fed changed its assessment to state there has been "modest further progress toward the committee's 2% inflation objective".
     - This compares with the previous policy statement where the Fed said there was a "lack of further progress".
   - Jerome Powell acknowledged the recent improvement in the inflation trend, but stressed the central bank will need to see more similar data before gaining confidence that inflation will fall towards 2%.

3. **Fed's economic forecasts**

   - 2024 economic growth forecast was unchanged at 2.1%, with Fed Chairman Powell saying the US economy continues to grow at a solid pace.
   - Powell mentioned the US labour market remains strong, though gradually cooling and re-balancing to pre-pandemic levels.
   - 2024 core Personal Consumption Expenditures (PCE) inflation projection was raised from 2.6% to 2.8% though the Fed still expects core inflation to fall to the 2% target in 2026.

4. **UOB house view**

   - The Fed will keep interest rates unchanged at 5.25% - 5.50% in July.
   - We still expect the Fed to deliver two 25 bps rate cuts in September and December.
   - However, if inflation stays persistent or re-accelerates, the timing of the first rate cut may be delayed.
   - Even when the Fed starts to ease, we do not expect a series of aggressive rate cuts.

What you can do

- As interest rate cuts are still expected later this year, you should be looking to enhance your investment income.
- You can do so by complementing bond funds and investment grade bonds where yields remain attractive, with dividend-paying stocks that can also provide potential capital growth.
- Be proactive in your investments and diversify your portfolio as market trends may change ahead of the Fed's rate cut. Anchor your portfolio with Core investments such as multi-asset strategies that can lower portfolio volatility while capture opportunities in different asset classes, sectors, and regions.
- If you are willing and able to take risk, accumulate quality stocks on dips, as they offer strong revenue growth, robust earnings and have lower debt.
- Speak to a UOB Advisor to build a portfolio that meets your investment goals.

Right By You

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