U.S. FOMC Review

- FOMC: target range for the federal funds rate unchanged at 5.25 to 5.50 percent; lack of further progress on inflation
- QT: adjustments to Treasury redemption cap to allow for longer balance sheet runoff
- Powell press conference: policy well-calibrated to address two-sided risks; incoming data will dictate the path of policy

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The FOMC left unchanged today the target range for the federal funds rate at 5.25 to 5.50 percent. While maintenance of the policy rate at its current level was endorsed by the entire Committee, officials saw fit to amend other aspects of the statement. Specifically, the Committee amended views on inflation to reflect stalled progress in Q1 and they announced upcoming changes to balance sheet policy.

The acknowledgement of stalled progress on the inflation side of the dual mandate was noted in the first paragraph of the May 1 statement: “In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective.” While on face the addition marked a departure from prior assessments of the trajectory of inflation, comments by Chair Powell during his press conference seemed to refute the idea that the Committee revised substantially its inflation outlook. In his opening remarks, the Fed Chair acknowledged that it was “going to take longer than previously anticipated” to “gain greater confidence that inflation is moving sustainably toward two percent.” That said, he argued that policy is “well positioned” to deal with evolving risks to both sides of the Committee’s dual mandate. Moreover, while he seemingly dodged a question about the current stance of policy being “sufficiently restrictive,” he reiterated that it is “restrictive” and emphasized that another hike in the target range for the federal funds rate was “unlikely” at this time. Powell stressed that officials would require “persuasive evidence” that the current policy setting was insufficient to return inflation to two percent over time.

Although another rate hike is unlikely at this juncture, neither the statement nor Chair Powell offered clear guidance on the path of policy aside from noting that achievement of inflation objectives may take longer than previously anticipated. Avoiding taking a more hawkish turn, he demurred from answering whether the Committee had abandoned its easing bias by indicating that policy was “well positioned” to address risks. Further, he emphasized that he saw “paths” that involve cutting the federal funds rate and paths that don’t without indicating which path he saw as having a higher probability of occurring. Forecasting in the post-pandemic period remains challenging, and policymakers will rely on the data to inform the path of interest rates.

The second major change involved balance sheet policy, with the Committee announcing that as of June 1st, the monthly redemption cap on maturing Treasury securities in the SOMA portfolio will be reduced from $60 billion to $25 billion. The Committee left unaltered the redemption cap for agency mortgage-backed securities at $35 billion, although redemptions have averaged only around $15 billion per month. Additionally, should the cap be breached, maturing MBS would be reinvested in Treasury securities. The move, in our view, was a prudent one, as it facilitated the ongoing transition from an “abundant reserves” regime to one of “ample reserves” while attempting to preempt emergence of stress in short-term funding markets. Proceeding slowly with redemptions amid uncertainty about the equilibrium level of reserves in the desired policy framework, and preventing unwanted deterioration of market function, will allow for ongoing reduction of the securities portfolio – a goal seemingly desired by officials. Thus, given upcoming adjustments to QT, and comments by Chair Powell indicating that the shift does not indicate less total runoff than previously expected, we suspect that QT will be ongoing for at least some time – likely well into the second half of 2024 (or early 2025) provided ongoing smooth market function.