U.S. FOMC Review

- FOMC: uneventful

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February FOMC: No Meaningful Changes

The Federal Open Market Committee, as widely expected, did not alter its policy stance, and it made only marginal changes to its policy statement. The most notable shift in the statement was the inclusion of a new sentence indicating that consumer and business sentiment had improved (statement comparison, next page). That sentence would seem to add a hawkish tilt to the policy leanings of the Committee, but we would not push this view too far.

The Committee altered the text relating to inflation by dropping references to the effects of past declines in energy prices and prices of non-energy imports. Again, this shift could be interpreted as a hawkish change because it suggests less restraint on inflation going forward. However, the statement stopped well short of expressing concern about an acceleration in inflation. Indeed, the collective expectation of the Committee is that inflation will gradually return to the target of two percent.

Many market participants saw the possibility of new information on plans for trimming the Fed's portfolio, but the statement on reinvestment was exactly the same as it has been at other recent meetings. We were not surprised by such an outcome. This issue was discussed extensively at the November meeting, and officials saw no urgency in altering the current practice of reinvesting maturing and repaid securities; they planned to retain the current system "for some time". Chair Yellen summarized the discussion by noting that the Committee would "proceed cautiously" on this front and would announce any changes "well in advance" of the shift. The November minutes also noted that most Fed officials did not favor using the balance sheet (i.e. buying and selling of securities) as an active policy tool. Such activity was seen as useful when short-term interest rates are at the zero lower bound, but policymakers favored the continued use of short-term interest rates as the active policy tool in other circumstances.

FOMC Statement Comparison

Economic Setting and Current Policy Decision

Feb. 1, 2017 FOMC Statement (In Part)*

Information received since the Federal Open Market Committee met in December indicates that the labor market has continued to strengthen and that economic activity has continued to expand at a moderate pace. Job gains remained solid and the unemployment rate stayed near its recent low. Household spending has continued to rise moderately while business fixed investment has remained soft. **Measures of consumer and business sentiment have improved of late.** Inflation increased in recent quarters but is still below the Committee's 2 percent longer-run objective. Market-based measures of inflation compensation remain low; most survey-based measures of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace, labor market conditions will strengthen somewhat further**,** and inflation will rise to 2 percent over the medium term. Near-term risks to the economic outlook appear roughly balanced. The Committee continues to closely monitor inflation indicators and global economic and financial developments.

Dec. 14, 2016 FOMC Statement (In Part)*

Information received since the Federal Open Market Committee met in November indicates that the labor market has continued to strengthen and that economic activity has been expanding at a moderate pace since mid-year. Job gains have been solid in recent months and the unemployment rate has declined. Household spending has been rising moderately but business fixed investment has remained soft. Inflation has increased since earlier this year but is still below the Committee's 2 percent longer-run objective, **partly reflecting earlier declines in energy prices and in prices of non-energy imports.** Market-based measures of inflation compensation **have moved up considerably but still are low**; most survey-based measures of longer-term inflation expectations are little changed, on balance, in recent months.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace and labor market conditions will strengthen somewhat further. Inflation is expected to rise to 2 percent over the medium term **as the transitory effects of past declines in energy and import prices dissipate and the labor market strengthens further.** Near-term risks to the economic outlook appear roughly balanced. The Committee continues to closely monitor inflation indicators and global economic and financial developments.

Forward Guidance (No change from December to February)

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its objectives of maximum employment and 2 percent inflation. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments. In light of the current shortfall of inflation from 2 percent, the Committee will carefully monitor actual and expected progress toward its inflation goal. The Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data.

The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction, and it anticipates doing so until normalization of the level of the federal funds rate is well under way. This policy, by keeping the Committee's holdings of longer-term securities at sizable levels, should help maintain accommodative financial conditions.

* *Emphasis added.*

Source: Federal Open Market Committee; Daiwa Capital Markets America