Daiwa Capital Markets

U.S. FOMC Review

- FOMC: market friendly; possibly finished tightening

Michael Moran
Daiwa Capital Markets America
212-612-6392
michael.moran@us.daiwacm.com

Monetary Policy

The policy statement of the Federal Open Market Committee and press conference of Chairman Powell were notable. At the very least, the new information suggests a long pause in the tightening process; one could reasonably argue that the tightening cycle could be over.

One indication of a shift in views at the Fed was evident in the first sentence of the policy statement, where economic growth was described as "solid", a downgrade from the characterization of "strong" in December. More important, the Committee altered the second paragraph of the statement, which offers guidance on policy in the months ahead (see the next page for a comparison). Previously, the paragraph made reference to "further gradual increases" in the federal funds rate. The new statement dropped this sentence and replaced it with an indication that the Fed would be "patient" in deciding future adjustments. Indicating patience was important, but perhaps more important was the reference to "future adjustments", which could involve a cut in rates rather than an increase. A reporter in the press conference asked Chairman Powell if the new wording opened a door to a rate cut. The Chairman's vague answer seemed to support this interpretation, as he indicated that he had no strong prior conviction.

The second paragraph also dropped a sentence indicating that the Committee viewed risks to the economic outlook as balanced. While the statement was noncommittal on the balance of risks, The Chairman's press conference left a clear impression that he viewed risks as on the downside. He mentioned "crosscurrents" in his prepared remarks (slower global economic growth, tighter financial conditions, heightened policy uncertainties), and in the Q&A session he noted that the crosscurrents could be present for some time. When asked about the marked shift in his tone from December to now, Mr. Powell again cited crosscurrents.

The FOMC issued a separate statement on its balance sheet, which provided two clarifications on this element of policy. First, the Committee views the balance sheet as a possible tool of monetary policy. The federal funds rate is the primary tool, but the Committee is willing to alter the size and composition of the balance sheet if warranted by economic conditions. This official statement was in line with public comments made by Mr. Powell in recent weeks, and no doubt was intended to clarify misperceptions created by his comment at the December press conference that redemptions of Treasury securities were on autopilot.

The second clarification involved the operating procedure of the FOMC, with the Committee indicating that it would continue to use the current procedure of controlling the federal funds rate by altering the Fed's administered rates (the rate on overnight reverse RPs and the rate on excess reserves). This operating procedure is in contrast to that in place before the financial crisis, where the Fed maintained a tight supply of reserves in the banking system and influenced the funds rate by frequent open market operations. This confirmation is important because the current procedure allows the Fed to operate with a large balance sheet, and thus, the Committee might not be far away from a portfolio size that might be viewed as normal.

FOMC Statement Comparison

Jan. 30, 2019 FOMC Statement (In Part)

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

Source: Federal Open Market Committee

Dec. 19, 2018 FOMC Statement (In Part)

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee judges that some further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term. The Committee judges that risks to the economic outlook are roughly balanced, but will continue to monitor global economic and financial developments and assess their implications for the economic outlook.