U.S. FOMC Review

- FOMC: no policy change; technical adjustment only
- Press briefing: focus on inflation

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FOMC

As widely expected, the Federal Open Market Committee did not alter monetary policy at today's meeting. The Fed made a technical adjustment, as the Board of Governors reduced the rate paid on required and excess reserves by five basis points to 2.35 percent.

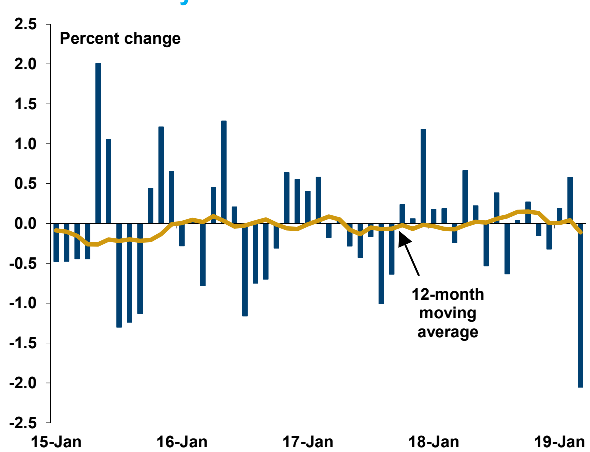
Some market participants might argue that that the drop in IOER represents a subtle easing in policy, but we would not view it as such. The change was made simply to keep the federal funds rate more comfortably within its target range of 2.25 to 2.50 percent. The effective fed funds rate has totaled 2.44 percent in most recent days and has touched 2.45 percent at times. The change was market friendly in that it signaled the Fed wants to keep the funds rate in the middle of the target range rather than the upper portion, but it does nothing to alter the target range. Chairman Powell supported this view by emphasizing in his press conference that the change did not represent a shift in policy and had no implications for policy in the future.

Some market participants have been puzzled by the fact that federal funds have traded at rates above the IOER. The experience of the past few years, and commentary from the Fed, suggested that IOER would be a ceiling on the federal funds rate. However, conceptually or theoretically, IOER should be a floor on the federal funds rate. As a practical matter, market frictions will often push the IOER above the federal funds rate, but instances of the reverse should not be surprising. We will provide a fuller discussion in our weekly economic commentary on Friday.

The press conference of Chairman Powell was dominated by questions regarding the policy implications of slow inflation. Mr. Powell indicated that the Fed is committed to hitting the target of two percent inflation, but he stopped well short of opening the possibility of cutting interest rates to reach this goal. He noted that officials were comfortable with the current policy stance, and he argued that inflation in the first quarter was probably restrained by transitory factors. When pressed, he cited large declines in airfares and prices of portfolio management services and apparel. He has a point, as the chart below shows that a weighted average of these items (using broader financial services category rather than portfolio management) did indeed fall sharply in March and helped to restrain inflation (chart, left). He also cited stability in trimmed-mean PCE inflation (chart, right)

The bottom line: the Fed is on hold. As Chairman Powell noted more than once, there is not a strong case for either an increase or a decrease in rates.

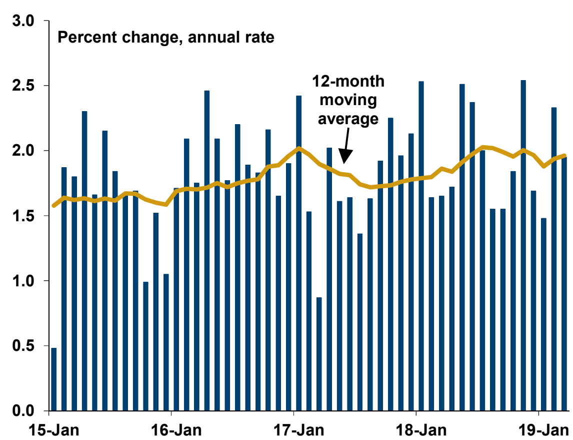
CPI: Transitory Influences*



* *A weighted average index constructed from the Apparel, Airline Fare, and Financial Services components of the Consumer Price Index. Weights are derived from the relative importance of each component in the CPI.*

Source: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Trimmed-Mean 1-Month PCE Inflation



PCE = personal consumption expenditures

Source: Federal Reserve Bank of Dallas via Haver Analytics