Daiwa Capital Markets

U.S. FOMC Review

- FOMC: strong dovish shift

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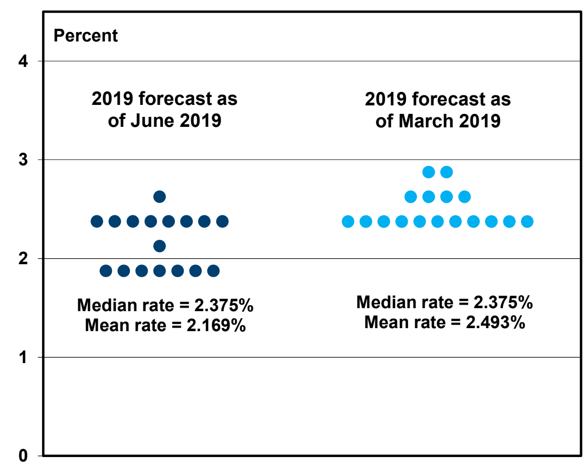
FOMC: Prepared to Ease Policy

We were struck by two elements of the new information from the Federal Open Market Committee: a pronounced shift in the dot plot and a marked change in the forward-guidance portion of the policy statement.

The new dot plot shows eight policymakers expecting to ease policy this year, with seven expecting two rate cuts (or one 50 basis-point shift). One official expects to raise the funds rate by 25 basis points. The new plot represents a pronounced shift from the one in March when no one expected easier policy and six expected to hike interest rates (chart). The median dot did not change from March (still at 2.375 percent), but the mean expectation of Fed officials fell 32 basis points (2.169 percent versus 2.493 percent). We expected a downward tilt in the plot, but we did not envision eight officials shifting to easier policy. Moreover, Chairman Powell noted in his press conference that some individuals showing no change in policy understood downside risks and would be willing to consider easier policy. In short, there has been a profound shift in Fed views.

FOMC Rate View: Year-End 2019*



** Each dot represents the expected federal funds rate of a Fed official at the end of 2019. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the March 2019 and June 2019 meetings.*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2019 and March 2019

The important issue on forward guidance was whether officials would indicate a “patient” approach to policy adjustments. We expected the officials to drop “patient” from the statement, but we looked for them to replace it with a close substitute. They did not; the new guidance carried a strong suggestion of providing accommodation. (The key sentence: “In light of these uncertainties [in the economic outlook] and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective.”)

Our sense before today’s meeting was that the expectations of market participants were well ahead of the Fed. That is not the case, as the FOMC seems fully on board for additional easing. We had expected steady policy over the balance of the year and easing to begin next year, but odds now strongly favor rate cuts this year, probably two.

Mr. Powell noted in his press briefing that potential developments on the trade front, along with an associated slowdown in business investment because of trade uncertainties, were key considerations behind the shift in policy prospects. He also emphasized an apparent slowdown in global economic activity. These factors should be the focus of analysts and market participants in judging the timing of rate cuts.