Daiwa Capital Markets

U.S. FOMC Review

- FOMC: not especially aggressive; “a mid-cycle adjustment”

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FOMC

The Federal Open Market Committee, as widely expected, cut the federal funds rate by 25 basis points, and it kept a door open to additional cuts in the future. However, we did not view the signals for future adjustments as especially aggressive. We were looking for two key phrases in its forward guidance: “closely monitor” and “act as appropriate to sustain the expansion”. The Fed kept the latter phrase, but it dropped “closely” in indicating its intention to monitor developments. We would not push the significance of this wording change too far, but it did weaken the statement to a degree.

Dissents by two Fed officials surprised us and dampened somewhat prospects for future action. Both Ester George of the Kansas City Fed and Eric Rosengren of the Boston Fed preferred to hold rates steady at this meeting. Ms. George is a well-established hawk, and Mr. Rosengren has shifted to the hawkish side in the past year or two, and thus their dissents were not shocking. Nevertheless, the stage had seemed so firmly set for a rate cut that we were expecting little controversy. Given this resistance, forming a consensus for future changes might be difficult.

Chairman Powell’s press conference also suggested that the Fed might not be active in the future. He characterized the change as a “mid-cycle adjustment” and noted that it was not the beginning of an extended easing cycle. He noted that the Committee simply wanted to move to a “somewhat” more accommodative policy stance. He also indicated that interest rates in the future could increase. He emphasized that he was not predicting rate hikes, but the fact that he recognized this possibility reinforced the view that today’s change did not represent the beginning of a long series of downward adjustments.

The Fed decided to end the redemption of Treasury and mortgage-backed securities immediately rather than at the end of September. This shift might be viewed as market friendly and a signal of the Fed’s intention to provide support to the economy. However, in the press conference, Chairman Powell downplayed its significance, noting that this action was taken for “simplicity and consistency”. It was not perfectly clear what he meant by this phrasing, but it was clear that he did not view the change as important. Indeed, the effect should be small, as the Fed was scheduled to redeem only $15 billion of Treasuries in August and $13 billion in September -- a pittance relative to what was purchased during QE and what has been redeemed thus far during normalization.

FOMC Statement Comparison

July 31, 2019 FOMC Statement (In Part)*

Information received since the Federal Open Market Committee met in June indicates that the labor market remains strong and that economic activity has been rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although growth of household spending has picked up from earlier in the year, growth of business fixed investment has been soft. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation **remain low**; survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to **lower** the target range for the federal funds rate to **2 to 2-1/4 percent**. This action supports the Committee's view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective are the most likely outcomes, but uncertainties about this outlook **remain**. As the Committee contemplates the future path of the target range for the federal funds rate, it will **continue to 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.

The Committee will conclude the reduction of its aggregate securities holdings in the System Open Market Account in August, two months earlier than previously indicated.

June 19, 2019 FOMC Statement (In Part)*

Information received since the Federal Open Market Committee met in May indicates that the labor market remains strong and that economic activity is rising at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although growth of household spending appears to have picked up from earlier in the year, indicators of business fixed investment have been soft. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation **have declined**; survey-based measures of longer-term inflation expectations are little changed.

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, but uncertainties about this outlook **have increased**. In light of these uncertainties 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.

Forward Guidance (Third Paragraph; No change from June to July)

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 maximum employment objective and its symmetric 2 percent inflation objective. 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.

** Emphasis added*
Source: Federal Open Market Committee; Daiwa Capital Markets America