Daiwa Capital Markets

U.S. FOMC Review

- FOMC minutes: a friendly Fed

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

The September FOMC Meeting

The outcome of the September meeting of the Federal Open Market Committee suggested a wide divergence of views among policy makers: two dissented from the decision of a 25 basis points rate cut in favor of no change in policy; one dissented in favor of a 50 basis point adjustment. However, the minutes from the meeting left us with the impression that the Committee did not have a serious debate on alternative outcomes and that there was little doubt about the decision to cut by 25 basis points. The minutes did not have obvious clues about the likelihood of another shift this year, but the tone of the discussion leads us to conclude that officials will favor another adjustment unless the economic data show a noticeable pickup.

In reviewing the economic situation, the minutes noted that “a clearer picture of protracted weakness in investment spending, manufacturing production, and exports had emerged.” In addition, officials generally noted that downside risks had increased since their previous meeting. Consumer spending was viewed as firm, but softness elsewhere could slow hiring, which could dampen support from households. “Several” officials noted that models designed to gauge recession risks had slipped notably in recent months. In addition to this soft setting, inflation was viewed as muted, and various measures of inflation expectations were near historical lows.

The downbeat tone to the minutes leads us to suspect that officials will be leaning toward another cut this year, quite likely at the meeting on October 30. The Committee’s discussion of its long-run policy strategy which is now under review also pointed in the direction of additional support. The Fed is now reviewing policy strategies to deal with the low level of neutral interest rates that has emerged and the strong likelihood the policy rate will return to the zero lower bound in the event of a recession. The minutes noted that the experience of foreign economies with extended periods of zero interest rates led Fed officials to believe that aggressive action before the lower bound is reached would help to forestall such outcomes in the United States. This view is in line with a recent speech by John Williams of the New York Fed, where he argued that the Fed should not save its ammunition for pronounced weakening; it is best to act early and aggressively to prevent softening. Thus, we look for the Fed to err on the side of accommodation.

The disruption in the money market that emerged in mid-September did not seem to receive extensive discussion at the meeting. The staff briefed officials on developments, and some possible solutions were mentioned (allowing the balance sheet to expand, establishing a standing RP facility), but in the end, the minutes merely noted that “the Committee should soon discuss the appropriate level of reserve balances sufficient to support efficient and effective implementation of monetary policy…” However, in his speech yesterday, Chair Powell indicated that the Fed would soon begin the expansion of its balance sheet.