Daiwa Capital Markets

U.S. FOMC Review

- FOMC: on hold for now; some expectation for rate hikes next year and in 2021…
- …but also wiggle room for rate cuts

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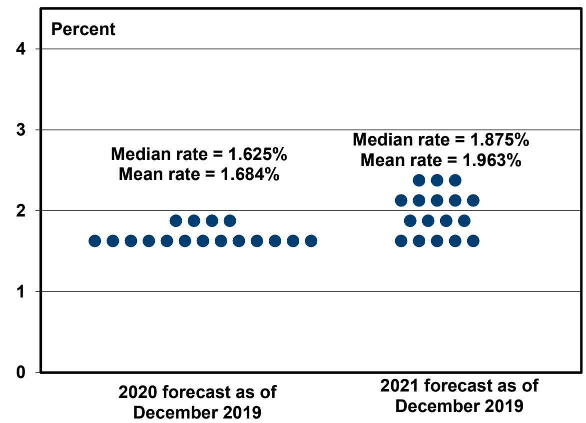
FOMC

The decision at today's meeting of the Federal Open Market Committee apparently was an easy one, as the latest Summary of Economic Projections showed that all 17 officials expected the federal funds rate to remain at 1.625 percent at the end of the year; no one intended to argue for a policy change at this meeting.

Officials also expect to be on hold for some time, as both the policy statement and the new dot plot suggested patience. The policy statement implied steady policy, as it noted that "the current stance of monetary policy is appropriate…" In addition, officials seemed confident in this view in that they dropped from the statement a reference to uncertainties in the outlook. However, the statement made an oblique reference to uncertainties, as it noted that officials will monitor "global developments" in making future decisions. We suspect that policymakers were thinking about the implications of slow activity in foreign economies or fallout from the trade war. Also, Chair Powell made reference in his prepared remarks to "ongoing risks", and he noted in the Q&A that issues related to global economic activity and trade disputes have not gone away.

FOMC Rate View: Year-End 2020 & 2021*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2020 and 2021. 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 December 2019 meeting.*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2019

The latest dot plot was interesting, as it did not show any expectation of further easing. The lowest reading on the Federal funds rate was the current target of 1.50 to 1.75 percent. Some officials expect to be hiking rates again next year, as four policymakers expect the target fed funds rate at the end of 2020 to be 25 basis points above the current level. For 2021, 12 of 17 officials expect to raise interest rates, with views ranging from one to three hikes of 25 basis points (chart).

We are not surprised that no Fed official saw the possibility of lower interest rates. Such a projection would imply failure in keeping the economy on track, and it would raise questions about why an expected cut is being delayed. If officials are

Economic Projections of the FOMC, December 2019*

	2019	2020	2021	2022	Longer Run
Change in Real GDP	2.2	2.0	1.9	1.8	1.9
Sept. projection	2.2	2.0	1.9	1.8	1.9
Unemp. Rate	3.6	3.5	3.6	3.7	4.1
Sept. projection	3.7	3.7	3.8	3.9	4.2
PCE Inflation	1.5	1.9	2.0	2.0	2.0
Sept. projection	1.5	1.9	2.0	2.0	2.0
Core PCE Inflation	1.6	1.9	2.0	2.0	--
Sept. projection	1.8	1.9	2.0	2.0	--
Federal Funds Rate	1.6	1.6	1.9	2.1	2.5
Sept. projection	1.9	1.9	2.1	2.4	2.5

** Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2019 pleased with the current performance of the economy, and if they view policy as in a good place, steady policy is the appropriate call. We would note, though, that the statement hinted at some possibility for rate cuts. As mentioned above, the statement noted that officials will be monitoring “global developments” in making policy decisions, and thus shocks from slow growth abroad or adverse developments in trade negotiations could prompt action. In addition, the statement noted that the FOMC will take account of “muted inflation pressures” in setting policy, opening the possibility of more support in the event of even modest easing in the pace of economic growth. Despite the steady or higher rates signaled in the dot plot, we are not inclined to change our expectation of two rate cuts next year.

We viewed Chair Powell as having a friendly tone in the press briefing. When asked about conditions that would prompt a rate hike, he indicated that he would need to see a significant and persistent increase in inflation. At other points he indicated that the labor market still has some slack and that unemployment can run at lower levels than previously believed without generating price pressure. Such comments also lead us to be comfortable with the view that additional rate cuts are possible.

FOMC Statement Comparison*

Dec. 11, 2019 FOMC Statement (In Part)	Oct. 30, 2019 FOMC Statement (In Part)
Information received since the Federal Open Market Committee met in October 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 household spending has been rising at a strong pace, business fixed investment and exports remain weak. 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. The Committee decided to maintain the target range for the federal funds rate at 1-1/2 to 1-3/4 percent. **The Committee judges that the current stance of monetary policy is appropriate to support** sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective. The Committee will continue to monitor the implications of incoming information for the economic outlook**, including global developments and muted inflation pressures**, as it assesses the appropriate path of the target range for the federal funds rate.	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 1-1/2 to 1-3/4 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**. The Committee will continue to monitor the implications of incoming information for the economic outlook as it assesses the appropriate path of the target range for the federal funds rate.
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.	
The first and third paragraphs of the FOMC statement were essentially unchanged between October and December.	

* *Emphasis added*

Source: Federal Open Market Committee; Daiwa Capital Markets America