Daiwa Capital Markets

U.S. FOMC Review

- FOMC: technical adjustments

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Steady Monetary Policy

As widely expected, the Federal Open Market Committee did not fundamentally alter monetary policy at today's meeting. However, Fed officials made minor adjustments to key interest rates, boosting both the interest rate on reserves and the rate on reverse repurchase agreements by 5 basis points, to 1.60 percent and 1.50 percent, respectively. These changes should be viewed as technical adjustments designed to nudge the federal funds rate closer to the midpoint of the 1.50 to 1.75 percent target range. (Federal funds have recently been trading at a rate close to 1.55 percent).

The Fed also made a minor adjustment to its plans for open market operations. The New York trading desk will now continue to arrange overnight and term repurchase agreements at least through April. The previous plan was to arrange these transactions, which inject reserves into the banking system, at least through January. The Fed did not alter its plan to buy Treasury bills at least into the second quarter.

Reporters raised the issue of bill purchases and RPs several times at the press conference, with the queries focused on plans for the future and the effect on the stock market. In terms of plans, Chair Powell provided only general guidelines, indicating that the Fed would continue the operations until it was confident that the supply of reserves in the banking system was ample. He anticipated that this objective would be accomplished sometime during the second quarter. He noted that the operations would be altered (lightened) in the months ahead. That is, the volume of RPs would be reduced and their interest rates increased; bill purchases would be trimmed. Some asked what level of reserves constituted an ample supply. Chair Powell indicated that the volume of reserves would fluctuate with the shifts in the Fed's liabilities (such as the Treasury General Account and currency held by the public), but $1.5 trillion would represent the bottom of a range.

The effect of the Fed's operations on financial markets -- especially the equity market -- is a bigger issue, and here Chair Powell shifted positions slightly. In December, he argued that bill purchases were not QE; they were not designed to affect long-term asset prices or to provide stimulus. Today, he noted that the intention of the operations was simply to supply bank reserves and to promote the smooth operation of the money market, but he also added that one can never be sure what might be driving financial markets. He seemed to be showing some sympathy to the view offered by Dallas Fed President Robert Kaplan that bill purchases were having a derivative effect on the prices of risk assets.

The FOMC made a small adjustment in its policy statement, indicating that officials expect that the current policy stance was consistent with inflation "returning" to the Committee's symmetric two percent objective. In December, the statement saw inflation as "near" the FOMC's target. When asked about the change, Chair Powell noted that the wording shift carried some significance. Officials wanted to convey the view that they are not comfortable with inflation below target and that two percent does not represent a ceiling on inflation.

Other notable points from the press conference: Chair Powell again suggested that policy is on hold by noting that policy is "appropriate" and is likely to remain appropriate if the economy unfolds as expected. Questions on the effects of the Coronavirus were naturally raised. He saw the situation as serious, but it was too early to speculate on the influence. He talked more about the risks to China and Asia than to the US. Reporters were interested in the strategic review now underway, especially possible adjustments to the nature of the inflation target (such as targeting average inflation over time or other "make-up" strategies). He provided little information, as the review is still underway and details will not be revealed until the middle of the year. However, Chair Powell noted that a standing RP facility is not currently under discussion. He expects the Fed will return to this issue in coming months, and he sees a role for RPs in whatever new framework is adopted, but the Fed is not working on the details of an RP facility at this time.