Daiwa Capital Markets

U.S. FOMC Review

- FOMC: an improved economic outlook, but no hint of upcoming policy changes

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FOMC

As widely expected, the Federal Open Market Committee did not adjust policy at its latest meeting. Most observers were looking for an upgrade in the Committee's assessment of the economy, and it did not disappoint, as the statement noted that recent economic indicators "have strengthened", firmer language than that in March, when indicators were said to have "turned upward". The policy statement also recognized an uptick in inflation, but it noted that the increase largely reflected transitory factors.

The Committee made a modest but possibly interesting change in the paragraph discussing the influence of Covid. Previously, the statement noted that the virus created risks for economic activity, employment, and inflation. Today's statement noted only risks to the economy. Perhaps "the economy" could be viewed as encompassing employment and inflation, but it also might reflect the possibility of firmer labor markets and the end of downward pressure on prices because of the pandemic.

Many market participants expected the Fed to increase the interest rates on excess reserves and reverse repurchase agreements to lift money market rates off their near-zero levels. In the event, the Fed kept these rates unchanged at 0.10 percent and 0.0 percent, respectively. Chair Powell noted in his press conference that policymakers did not see a need to hike the rates at this time because the fed funds rate (averaging 0.07 percent) is close to the midpoint of its target range. Other public comments of Fed officials in recent weeks also suggested that the federal funds rate is the key variable driving decisions on IOER and the rate on RRPs. The Fed also would probably respond if money market rates moved noticeably into negative territory, but only a handful of such transactions have occurred thus far.

The issue of tapering the QE program arose several times in the press briefing, and Chair Powell consistently indicated that now is not the time to consider such a move. The FOMC kept with its vague forward guidance on QE (maintained until the Fed achieves "substantial further progress" toward its policy goals), and he consistently noted that employment and inflation were far from where the Fed wanted them to be.

Reporters at the briefing also asked about a possible stirring of inflation, and Chair Powell was well prepared for this question. In fact, at one point he appeared to be reading a prepared response. His message was that inflation is likely to pick up in the months ahead because of base effects (effects of the pandemic dropping out of year-over-year inflation calculations) and because of bottlenecks. He emphasized, though, that these effects are likely to be transitory. He also emphasized that the Fed would use its anti-inflation tools if persistent price pressure were to emerge.

We found an exchange on potential financial instability interesting. Chair Powell noted that there was some froth in the equity market and that low interest rates might be playing a role. However, he believed that the main driver was good progress in the distribution of vaccines, which has set the stage for a brisk economic recovery.