Daiwa Capital Markets

U.S. FOMC Review

- FOMC: interest rate liftoff in 2023, perhaps 2022
- Inflation: still viewed as transitory, but could be more persistent than expected
- QE: tapering under discussion

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The FOMC

The policy statement of the Federal Open Market Committee changed only modestly, but the meeting nonetheless involved substantial developments. Most important, officials boosted their projections for economic growth and inflation this year, and they lifted them modestly for 2022 and 2023 (table). The changes were large enough to trigger rethinking of the proper interest rate path, with the majority of Fed officials (13 of 18) now expecting to raise interest rates in 2023. The median dot shows two changes of 25 basis points (to a midpoint of 0.625 percent), while two officials see the possibility of six hikes, which would leave the federal funds rate at 1.625 percent (chart). A hike in interest rates next year is not out of the question, as seven policymakers see liftoff occurring in 2022.

Economic Projections of the FOMC, June 2021*

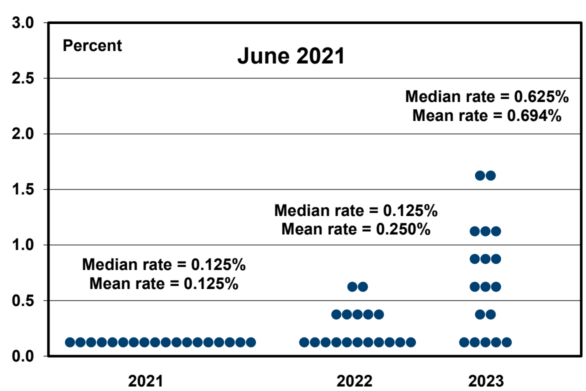
	2021	2022	2023	Longer Run
Change in Real GDP	7.0	3.3	2.4	1.8
March projection	6.5	3.3	2.2	1.8
Unemployment Rate	4.5	3.8	3.5	4.0
March projection	4.5	3.9	3.5	4.0
PCE Inflation	3.4	2.1	2.2	2.0
March projection	2.4	2.0	2.1	2.0
Core PCE Inflation	3.0	2.1	2.1	--
March projection	2.2	2.0	2.1	--
Federal Funds Rate	0.1	0.1	0.6	2.5
March projection	0.1	0.1	0.1	2.5

** Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2021

The dot plot showed a meaningful shift in interest rate expectations among Fed officials, but Chair Powell noted in his press conference that policymakers did not discuss interest rate hikes. Rather, they began to discuss alterations in the asset purchase program. Officials are not prepared to begin tapering in the near-term, but they plan to discuss the issue at upcoming meetings, and Chair Powell again indicated that the Committee would provide ample warning of a change in the program. We suspect that hints of change will become more frequent and more definitive in the weeks and months ahead (something more enlightening than "substantial further progress" toward the Fed's policy goals), with the tapering of Treasury purchases likely to begin after the turn of the year. We would not be surprised if the Fed began trimming purchases of MBS late this year.

FOMC Rate View: Year-End 2021, 2022, & 2023*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2021, 2022, and 2023. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but one governorship was open at the June 2021 meeting.*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2021

The most notable change in the forecasts of Fed officials was the jump in the expected inflation rate for this year, up a full percentage point from the view in March. Chair Powell noted in his press briefing that he and other policymakers expect that recent pressure will subside, a view evident in the subdued inflation rates of

2022 and 2023. However, Mr. Powell also admitted to upside risks. He noted that pressure could be more persistent than currently expected and that inflation expectations could wiggle higher. We found Chair Powell much less adamant in his previous view that inflation pressure this year would be transitory.

The FOMC increased the interest rate on reverse repurchase agreements by 5 basis points to 0.05 percent, and the Board of Governors made a comparable change to the interest rate on required and excess reserves (to 0.15 percent). These changes should not be viewed as a policy tightening; rather, they are technical adjustments that should lift other money-market interest rates and prevent them from moving into negative territory.