Daiwa Capital Markets

U.S. FOMC Review

- Powell testimony: unusual clarity

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

Monetary Policy Testimony

The prepared remarks of Chair Powell indicated clearly that the Fed intended to raise interest rates at its upcoming meeting (March 15-16): “With inflation well above 2 percent and a strong labor market, we expect it will be appropriate to raise the target range for the federal funds rate at our meeting later this month.” Mr. Powell had little to say about the situation in Ukraine other than it has generated uncertainty. That uncertainty will lead the Fed to move carefully, but with inflation an immediate issue, the Fed will move ahead with its plans to tighten.

While the Fed Chair was clear in his prepared remarks, he removed all doubts about likely actions in the Q&A session. When asked about prospects for the March FOMC meeting, Mr. Powell indicated that he would support a 25 basis point change and that he expected the Committee to form a plan to reduce the Fed’s balance sheet. We had the impression that this was a planted question; if not planted, Mr. Powell seemed to have a prepared response that he hoped to deliver at some point during the testimony.

We found other comments during the Q&A session to be enlightening. Mr. Powell noted a few times that the Fed would be adopting a series of rate increases, and he opened the possibility of a change greater than 25 basis points if inflation does not begin to ease later this year.

We were struck by the fact that Mr. Powell effectively accepted some responsibility for the current elevated inflation rate, as he noted that aggressive federal spending and easy monetary policy were important factors behind the current situation. He indicated that Congress and the Fed “turned our dials as hard as we could”. In addition, he noted that several factors have generated price pressure in this cycle, but inflation is essentially a monetary phenomenon.

Mr. Powell talked a bit about reducing the Fed’s balance sheet. He expects the FOMC to form a plan for trimming assets at the upcoming meeting, although that plan will not be finalized until a subsequent meeting. A Congressman asked about the time frame for reducing assets, and Mr. Powell indicated that he expected the adjustment to take approximately three years. Interestingly, the prepared remarks of Chair Powell obliquely opened the possibility of selling securities in order to reduce the size of the Fed’s portfolio: “Reducing our balance sheet will commence after the process of raising interest rates has begun, and will proceed in a predictable manner primarily through adjustments to reinvestments.” “Primarily” is the key word in this sentence; it suggests that other options are possible.