

U.S. FOMC Review

- FOMC: focused on inflation

Michael Moran

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

Monetary Policy

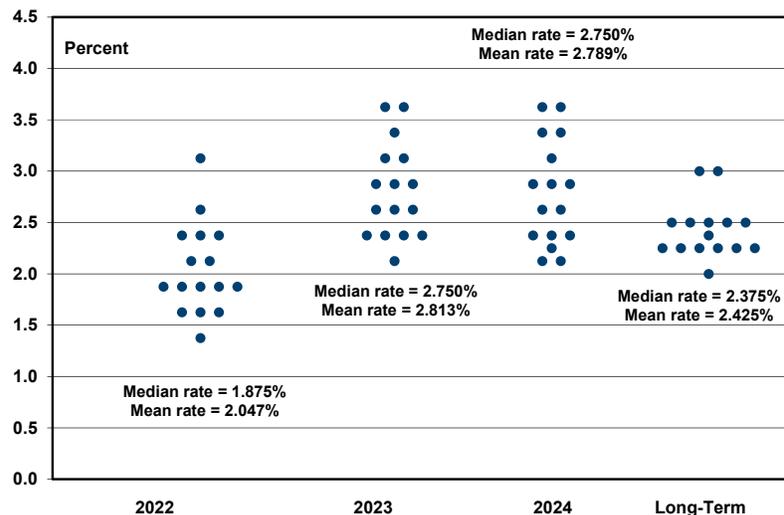
The new policy statement and the dot plot of the Federal Open Market Committee suggest that Fed officials are deeply concerned about the inflation environment. The policy statement in January attributed elevated inflation to supply and demand imbalances related to the pandemic and the reopening of the economy. The supply and demand imbalances were noted again, but so too were elevated energy prices and broader price pressures. We were especially struck by the inclusion of “broader price pressures”, as that addition could be viewed as a suggestion that policies (both fiscal and monetary) have played a role in fueling inflation.

If policy is fueling inflation, officials would need to move boldly to remove the pressure, and the dot plot indeed suggests that the Fed will be hiking aggressively. The median dot calls for a federal funds rate of 1.875 percent at the end of the year, a level that requires seven increases of 25 basis points. Going into the meeting, we were wondering if any policymaker would be looking for a federal funds rate at this level; we were shocked to see that 1.875 percent is now the central view of the FOMC. Seven officials expect the year-end federal funds rate to exceed 1.875 percent, with one official expecting a rate above three percent (chart). Such expectations will require either steps of more than 25 basis points or changes between FOMC meetings – aggressive actions. Next year, the median dot has monetary policy moving to a restrictive stance (i.e. a federal funds rate above the anticipated “long-run” reading of 2.4 percent; see the Summary of Economic Projections for the long-run view, which was revised down from 2.5 percent in December).

Chair Powell confirmed the strong hawkish tone in his press briefing. He described the economy as “very strong” and the labor market as “extremely tight”. He twice noted that officials were “acutely aware” of the importance of returning to price stability. When asked about the risk of tightening too rapidly, Mr. Powell answered that the probability of a recession was not elevated. Several times he noted that the strong economy could withstand tighter policy.

The summary of economic projections showed a noticeable slowing in GDP growth this year (a median expectation of 2.8 percent on a Q4-to-Q4 basis versus a projection of 4.0 percent in December, table). Mr. Powell described the new view as a still-

FOMC Rate View: Year-End 2022, 2023, 2024 & Long-Term*



* Each dot represents the expected federal funds rate of a Fed official at the ends of 2022, 2023, 2024, and long-term. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but three governorships were open at the March 2022 meeting. Moreover, only 15 Committee members provided forecasts for the long-term projection.

Source: Federal Open Market Committee, Summary of Economic Projections, March 2022

This report is issued by Daiwa Securities Group Inc. through its relevant group companies. Daiwa Securities Group Inc. is the global brand name of Daiwa Securities Co. Ltd., Tokyo (“Daiwa Securities”) and its subsidiaries worldwide that are authorized to do business within their respective jurisdictions. These include: Daiwa Capital Markets Hong Kong Ltd. (Hong Kong), regulated by the Hong Kong Securities and Futures Commission, Daiwa Capital Markets Europe Limited (London), regulated by the Financial Conduct Authority and a member of the London Stock Exchange, and Daiwa Capital Markets America Inc. (New York), a U.S. brokerdealer registered with the U.S. Securities and Exchange Commission, a futures commission merchant regulated by the U.S. Commodity Futures Trading Commission, and a primary dealer in U.S. government securities. The data contained in this report were taken from statistical services, reports in our possession, and from other sources believed to be reliable. The opinions and estimates expressed are our own, and we make no representation or guarantee either as to accuracy, completeness or as to the existence of other facts or interpretations that might be significant.

strong performance, one faster than the economy's potential at a time when the unemployment rate is already low – a performance that calls for the quick removal of policy accommodation.

Mr. Powell noted that the Committee made good progress in making plans for reducing the Fed's balance sheet, and that the process could begin soon, with an announcement possibly occurring after the May meeting. The Fed Chair did not provide any details on the effort, but he indicated that it would be similar to unwinding effort after the financial crisis.

Economic Projections of the FOMC, March 2022*

	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>Longer Run</u>
Change in Real GDP	2.8	2.2	2.0	1.8
December projection	4.0	2.2	2.0	1.8
Unemployment Rate	3.5	3.5	3.6	4.0
December projection	3.5	3.5	3.5	4.0
PCE Inflation	4.3	2.7	2.3	2.0
December projection	2.6	2.3	2.1	2.0
Core PCE Inflation	4.1	2.6	2.3	--
December projection	2.7	2.3	2.1	--
Federal Funds Rate	1.9	2.8	2.8	2.4
December projection	0.9	1.6	2.1	2.5

* Median projections

Source: Federal Open Market Committee, Summary of Economic Projections, March 2022