Daiwa Capital Markets

U.S. FOMC Review

- FOMC: some additional tightening, and a still-soft landing (with a few bumps)

Michael Moran
Lawrence Werther
Daiwa Capital Markets America
michael.moran@us.daiwacm.com
lawrence.werther@us.daiwacm.com

Another 50 Basis Points

The Federal Open Market Committee did not provide any surprises with its policy announcement, as the hike of 50 basis points in the federal funds rate was well telegraphed and widely expected. The policy statement was largely unchanged from the November version.

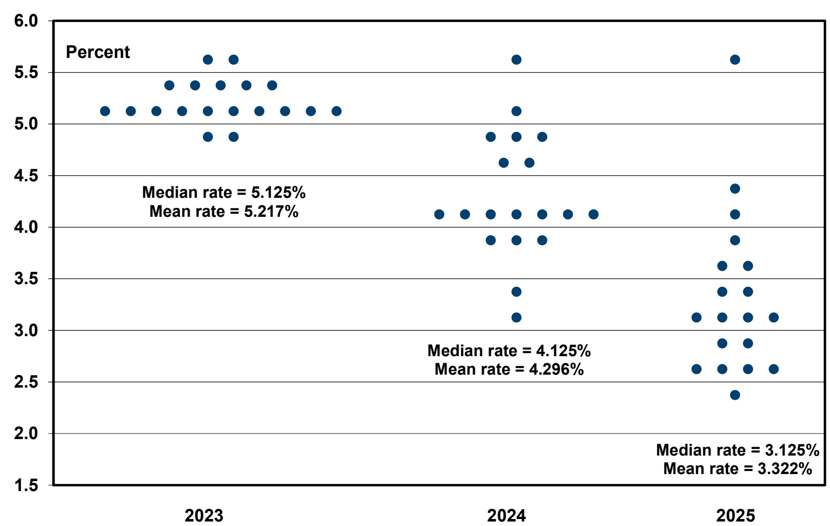
While the latest action of the Fed was in line with expectations, many market participants will be surprised and disappointed with the FOMC's new dot plot and the comments of Chair Powell at the press briefing. The new dot plot showed a median rate of 5.125 percent, 50 basis points higher than the September median. This view is widely shared among Fed officials, as 17 of the 19 policymakers see the funds rate above 5.0 percent at the end of 2023 (chart). Two policymakers expect the funds rate to climb to 5.625 percent (matching our projection). The configuration of the dots suggests that no official is expecting to pivot to lower interest rates, a view confirmed by Chair Powell in his press briefing.

Chair Powell's comments in the press conference carried a hawkish tone, as he noted that the Fed had more work to do in taming inflation. He reinforced the view in the dot plot by noting that the policy rate would probably move higher next year and he emphasized that the Fed would hold to a restrictive stance for some time. History, he noted, cautions against a premature easing of policy. The favorable report on consumer prices for November apparently had little influence on the views of Fed officials, as Mr. Powell indicated in both his prepared remarks and in the Q&A that it will take "substantially" more evidence to convince policymakers that inflation is on a path to two percent.

Mr. Powell was market friendly in one respect: he did not close a door on shifting to changes of 25 basis points next year. Two reporters raised the issue at the press briefing; he was elusive in answering, but he did not rule out such a change. He argued, as he did in November, that the speed of policy adjustment is now less important than the magnitude of the ultimate change and the length of time that restrictive policy is maintained.

The FOMC is less optimistic on the economy than it was in September, as expected growth is slower, unemployment is higher, and inflation is running faster than

FOMC Rate View: Year-End 2023, 2024 & 2025*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2023, 2024, and 2025.*
Source: Federal Open Market Committee, Summary of Economic Projections, December 2022

believed three months ago. The pickup in inflation, Chair Powell noted, is largely because inflation this year is quicker than previously expected. The slower pace of growth and the rise in unemployment reflect the tighter policy stance now envisioned. We also suspect that officials pulled projections in line with a realistic view, as the projections in September seemed to have an optimistic bias. The new view could still be viewed as a soft landing, as GDP growth remains in positive territory and the increase in unemployment is not alarming. At the same time, it is not a perfectly smooth landing.

Economic Projections of the FOMC, December 2022*

	2022	2023	2024	2025	Longer Run
Change in Real GDP	0.5	0.5	1.6	1.8	1.8
Sept. projection	0.2	1.2	1.7	1.8	1.8
Unemployment Rate	3.7	4.6	4.6	4.5	4.0
Sept. projection	3.8	4.4	4.4	4.3	4.0
PCE Inflation	5.6	3.1	2.5	2.1	2.0
Sept. projection	5.4	2.8	2.3	2.0	2.0
Core PCE Inflation	4.8	3.5	2.5	2.1	--
Sept. projection	4.5	3.1	2.3	2.1	--
Federal Funds Rate	4.4	5.1	4.1	3.1	2.5
Sept. projection	4.4	4.6	3.9	2.9	2.5

** Median projections*

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