Daiwa Capital Markets

U.S. FOMC Review

- FOMC minutes: officials focused on “unacceptably high” inflation
- Officials agreed that the banking sector remained sound…

  … but recent developments introduced a high degree of uncertainty into the outlook

Lawrence Werther
Daiwa Capital Markets America
212-612-6393
lawrence.werther@us.daiwacm.com

The March FOMC Meeting

- The minutes for the March meeting of the Federal Open Market Committee carried more weight than usual, as recent developments in the banking sector introduced a greater uncertainty into the range of potential outcomes for monetary policy. Economic data received early in the intermeeting period argued for potentially more forceful policy action than the 25-basis-point hike enacted at the prior FOMC meeting, with “some” participants viewing the data as calling for a 50-basis-point move. However, the unfolding of events following the failures of Silicon Valley Bank and Signature Bank ultimately led “all” Fed officials to adopt a more cautious tack (although one that did not involve a pause in hiking interest rates).

- While caution was emphasized, unacceptably high inflation ultimately led Fed officials to ratify a hike of 25 basis points. Participants acknowledged that inflation remained “well above” the Committee’s two-percent target and that recent data offered “few signs” that inflation pressures were easing at the necessary pace to return inflation to target over time. Moreover, meeting participants continued to view risks to the inflation outlook as skewed to the upside. They did acknowledged downside risks to the inflation outlook that could materialize if banks slowed the flow of credit to households and businesses by more than currently expected, but we viewed them as assigning lower probability to this potential outcome.

- Despite the continued focus on inflation, we view recent developments in the banking sector as undoubtedly affecting the outcome of the meeting and possibly the overall trajectory of the federal funds rate. While meeting participants “agreed that the U.S. banking system remained sound and resilient,” and that actions taken by the Federal Reserve and other government agencies had helped to calm conditions, they acknowledged that developments likely translated to tighter lending conditions that could slow the flow of credit to households and businesses. Moreover, participants suggested that it was “too early to assess with confidence the magnitude of the effect of a credit tightening on economic activity and inflation.”

- Interestingly, assessments of the economic effects of banking-sector stress led Fed staff to incorporate a mild recession into the 2023 outlook before recovery commenced in the subsequent two years (versus Fed officials’ expectations for subdued growth over the three-year period). With a near-term downturn expected to generate additional slack in product and labor markets, the staff forecast core inflation to slow sharply next year and for headline inflation to moderate in 2023 and track core in 2024 and 2025. In both 2024 and 2025, headline and core PCE inflation were projected to be close to the two-percent inflation target.

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.