Daiwa Capital Markets

U.S. FOMC Review

- FOMC: shift to data-dependent approach; still attentive to inflation risks

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The May FOMC Meeting

The Statement

- The Federal Open Market Committee raised the target range for the federal funds rate by 25 basis points at the conclusion of today's policy meeting to a range of 5.00 to 5.25 percent. The shift marked the 10th consecutive increase in the federal funds rate, with the cumulative adjustment of 500 basis pushing the target rate to its highest in 16 years.

- The Committee tweaked the verbiage of its description of economic conditions, but its assessment was broadly similar to that in March: economic activity expanded modestly, job gains were robust, the unemployment rate was low, and inflation remained elevated.

- The characterization of the banking system in the May statement was unchanged from that in March: sound and resilient. Risks stemming from recent developments are tied importantly to the degree of tightening in credit conditions ultimately experienced by households and businesses.

- The most substantive change to the statement occurred in the third paragraph with a tweak to forward guidance. The latest statement dropped the phrase: "anticipates that some additional policy firming may be appropriate," and it omitted mention of "future increases in the target range." Instead, the May statement included the phrase: "In determining the extent to which additional policy firming may be appropriate…"Anticipating additional policy firming no longer appears to be the base case.

The Press Conference

- In his opening statement, Chair Powell emphasized the Committee's strong commitment to returning inflation to two percent over time. He noted that the labor market remained "very tight" and that labor demand still far exceeded supply. He suggested that inflation had moderated somewhat, but that the Committee had a long way to go to get inflation back to its two percent target.

- Early on in the Q&A session, the Fed Chair received a question on whether the FOMC statement should be interpreted as signaling a pause at the June meeting. Chair Powell pushed back against this idea, arguing that the decision has not yet been made and will depend importantly on the incoming data.

- The Fed Chair did volunteer that tightening in credit conditions for households and businesses stemming from volatility in the banking sector did eliminate the need for additional hikes that may have previously been warranted. He avoided quantifying the degree of tightening in terms of rate hike equivalents (versus suggesting in the March press conference that it equaled one or two hikes), but he did say that the tightening was an important factor to be considered along with the cumulative shifts in policy already enacted by the Committee.

- Importantly, Chair Powell emphasized that the Committee's forecast projected inflation to recede slowly. Thus, the federal funds rate would have to remain elevated for some time to return inflation to target. His comments suggested that a near-term pivot to lower rates was unlikely, which differs from market expectations for a shift to a lower funds rate later this year.