Daiwa Capital Markets

U.S. FOMC Review

- FOMC: September minutes indicated that restrictive policy will be required for some time
- That said, comments by Fed officials this week suggest that recent developments could eliminate the need for additional rate hikes at upcoming meetings

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September FOMC Minutes

The minutes from the September meeting of the Federal Open Market Committee offered a view into officials' decision to leave unchanged the target range for the federal funds rate of 5.25 to 5.50 percent, while revising higher expectations for 2024 and 2025 in the new Summary of Economic Projections. Year-end rates in 2024 and 2025 were both projected to be 50 basis points higher than indicated in the June SEP at 5.125 percent and 3.875 percent, respectively, in response to a firmer growth outlook and inflation that would only return to target in 2026 (table).

Economic Projections of the FOMC, September 2023*

	2023	2024	2025	2026	Longer Run
Change in Real GDP	2.1	1.5	1.8	1.8	1.8
June projection	1.0	1.1	1.8	--	1.8
Unemployment Rate	3.8	4.1	4.1	4.0	4.0
June projection	4.1	4.5	4.5	--	4.0
PCE Inflation	3.3	2.5	2.2	2.0	2.0
June projection	3.2	2.5	2.1	--	2.0
Core PCE Inflation	3.7	2.6	2.3	2.0	--
June projection	3.9	2.6	2.2	--	--
Federal Funds Rate	5.6	5.1	3.9	2.9	2.5
June projection	5.6	4.6	3.4	--	2.5

** Median projections*
Source: Federal Open Market Committee, Summary of Economic Projections, September 2023

The minutes indicated that meeting participants viewed economic activity as expanding at a "solid pace" and that the economy "had been more resilient than expected." However, the current restrictive stance of monetary policy was expected to slow growth in the near term from its current trajectory. Regarding current inflation, participants acknowledged that it had "moderated somewhat" but "remained unacceptably high" and that "further evidence would be required for them to be confident that inflation was clearly on a path to the Committee's 2 percent objective."

Against the backdrop of solid growth and above-target inflation, but also considering "the significant cumulative tightening in the stance of monetary policy and the lags with which policy affects economic activity and inflation," the Committee kept rates unchanged. Although failing to adjust the target range for the federal funds rate, the minutes noted that the current restrictive stance of monetary policy "would support further progress toward the Committee's goals while allowing the Committee time to gather additional data to evaluate this progress." Thus, the Committee is well-positioned to "proceed carefully" at upcoming meetings while basing decisions on the "totality of the incoming information and its implications for the economic outlook as well as for the balance of risks."

The economic forecast prepared by the Fed staff for the September FOMC meeting was adjusted higher from that in July, reflecting consumer spending and business investment that were more resilient to tight financial conditions than previously anticipated. Strike activity by autoworkers could weigh on growth somewhat, but the effects were expected to be modest, and they were projected to be unwound in 2024 (providing a small boost to GDP). Over the 2024-26 horizon, growth was expected to be slower than that that in 2023 – and below the staff's estimate of potential – although the economy was still expected to avoid recession. With regard to inflation, the headline and core PCE price indexes were forecast to increase approximately 3.5 percent this year and moderate to 2.0 percent by 2026. However, the baseline forecast, while favorable, faced considerable uncertainty. Risks around the inflation forecast were skewed to the upside as "inflation could prove to be more persistent than expected." Should faster-than-anticipated inflation materialize, then the required policy response would shift growth risks to the downside.

Although “a majority” of participants anticipated that one additional hike of 25 basis points in the target range for the federal funds rate “would likely be appropriate,” views may have shifted since the time of the September FOMC meeting. Longer-term Treasury yields rose in August and had jumped after the meeting before retreating in recent days (the 10-year yield rose from approximately 170 basis points in the last week of July to a recent high of more than 240 basis points before retreating this week on news of developments in the Middle East). Inflation expectations remained largely unchanged over that period, suggesting much of the move occurred in real rates. Against this backdrop, Fed officials seemed to offer subtle shifts in views. Fed Governor Christopher Waller at an event in Utah earlier today noted that, “Financial markets are tightening up, and they are doing some of the work for us.” Similarly, in a speech on October 9th, Fed Vice Chair Philip Jefferson reiterated, “The FOMC is in a position to proceed carefully.” On the same day, Lorie Logan, the President of the Dallas Fed and a 2023 voter, said, “If long-term interest rates remain elevated because of higher term premiums, there may be less need to raise the federal funds rate.” Thus, officials remain data-dependent, and another hike could occur this year, but the odds appear to have diminished somewhat. That said, higher for longer is still the most likely scenario – even if another hike is taken off the table.