U.S. FOMC Review

- FOMC: target range for the federal funds rate unchanged at 5.25 to 5.50 percent, the likely peak for the current cycle
- SEP: inflation nudged lower in 2024 & 2025; economic growth a bit slower in 2024
- Dot Plot: signaling 75 basis points in cuts in 2024

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

December FOMC

The Federal Open Market Committee voted unanimously today to leave unchanged the target range for the federal funds rate at 5-1/4 to 5-1/2 percent, a move expected by market participants. The statement published at the conclusion to the two-day policy meeting was broadly similar to that released on November 1, although it contained adjustments to the description of economic conditions and inflation and to forward guidance on the possible path of the federal funds rate (paragraphs one and three, respectively). With regard to economic activity, the December statement noted that it had "slowed from its strong pace in the third quarter" rather than "expanded at a strong pace." With respect to inflation, the new statement tempered the assessment that it "remains elevated" by indicating that it "has eased over the past year."

The more important change, in our view, was the addition of the word "any" in the discussion of additional policy firming that may be required. When asked in the post-meeting press conference about the addition, Chair Powell indicated that it was an acknowledgement that the federal funds rate was at or near the peak for the cycle. He emphasized that the Committee doesn't want to take the possibility of additional rate hikes off the table, but we suspect that the bar for another increase would be exceedingly high.

The new Summary of Economic Projections (SEP) included adjustments to most key variables, including a shift in rate cut expectations for the next two years (discussed below). With regard to expectations for the economy, the median forecast for GDP growth in 2023 was revised substantially higher (2.6 percent versus 2.1 percent in September), which reflected the burst of 5.2 percent growth in Q3. The median for growth next year eased slightly (1.4 percent versus 1.5 percent; table). With little addition deceleration in growth anticipated, near-term expectations for the unemployment rate were largely unchanged from those in September (3.8 percent this year, with the rate increasing modestly to 4.1 percent next year). Projections for 2026 and in the longer run were increased by 0.1 percentage point to 4.1 percent. While growth is expected to remain mostly on track, officials saw recent improvement in the inflation data as opening the door to additional slowing in inflation next year beyond that forecast for the September SEP. That said, inflation is not expected to return to two percent until 2026 (the same as in September).

New projections for the path of interest rates likely provided a bigger surprise to market participants than did adjustments to other components of the SEP, with the December dot plot projecting three rate cuts in 2024 rather than the two forecasted at the time of the September FOMC meeting (4.625 percent versus 4.875 percent some expected; a final hike of 25 basis points in 2023 projected in the September dot plot ultimately did not occur; charts, next page). The median expectation for 2025 also declined (3.625 percent versus 3.875 percent, while median expectations for 2026 (2.875 percent) and the longer run (2.500 percent) were unchanged from those in September.

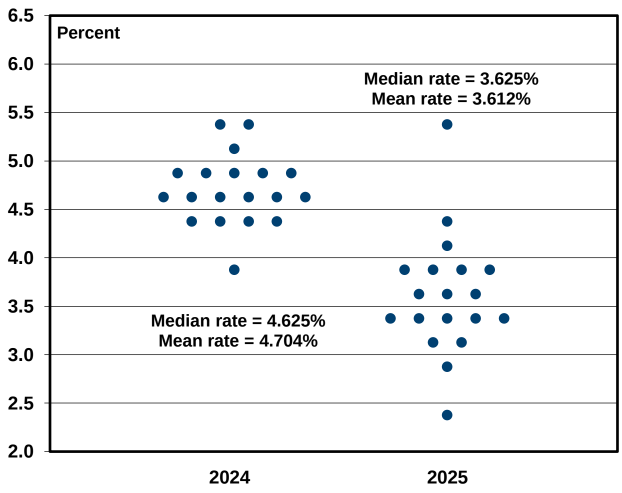
Economic Projections of the FOMC, December 2023*

	2023	2024	2025	2026	Longer Run
Change in Real GDP	2.6	1.4	1.8	1.9	1.8
Sept. projection	2.1	1.5	1.8	1.8	1.8
Unemployment Rate	3.8	4.1	4.1	4.1	4.1
Sept. projection	3.8	4.1	4.1	4.0	4.0
PCE Inflation	2.8	2.4	2.1	2.0	2.0
Sept. projection	3.3	2.5	2.2	2.0	2.0
Core PCE Inflation	3.2	2.4	2.2	2.0	--
Sept. projection	3.7	2.6	2.3	2.0	--
Federal Funds Rate	5.4	4.6	3.6	2.9	2.5
Sept. projection	5.6	5.1	3.9	2.9	2.5

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

In his post-meeting press conference, Chair Powell emphasized the Committee's ongoing commitment to achieving price stability and maximum sustainable employment. He noted progress in the fight against inflation, and he emphasized that a federal funds rate well into restrictive territory allowed the Committee to proceed carefully with regard to upcoming adjustments to monetary policy. Importantly, the Fed Chair noted that the economy in the post-pandemic period has consistently surprised forecasters; he refused to take the possibility of higher rates off the table, and he emphasized data dependence (flexibility) in the Committee's ongoing actions. At this time, he appears to believe that the economy is not in recession, and that recession is not the base case for 2024. Chair Powell seemed to imply that cuts could come in response to falling inflation rather than to counteract deterioration in economic conditions. Moreover, he pushed back against the idea that the Committee has formalized plans regarding a pivot to lower rates, both with respect to when it would occur and with regard to the magnitude of potential cuts. Despite his noncommittal statements regarding rate cuts, market participants seemingly viewed the Fed Chair's comments as unambiguously dovish. The two-year Treasury yield fell 30 basis points to 4.43 percent from yesterday's close, while the S&P 500 jumped almost 1.4 percent. We still suspect that a pivot will not occur for some time, perhaps at the June 2024 meeting, but today's market reaction reflects expectations that it could potentially occur sooner.

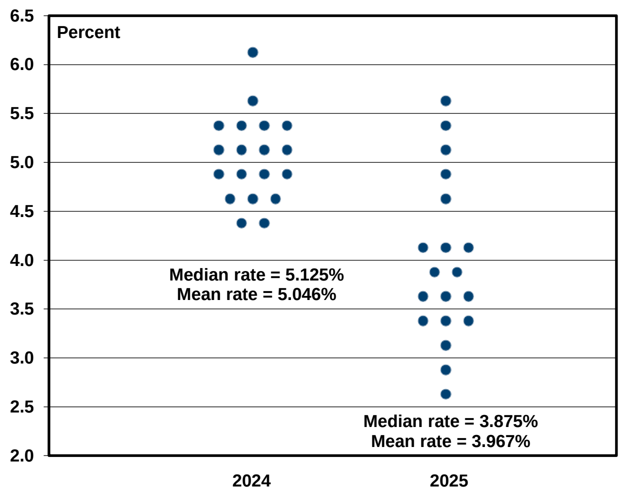
FOMC Rate View, December 2023*



** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2023

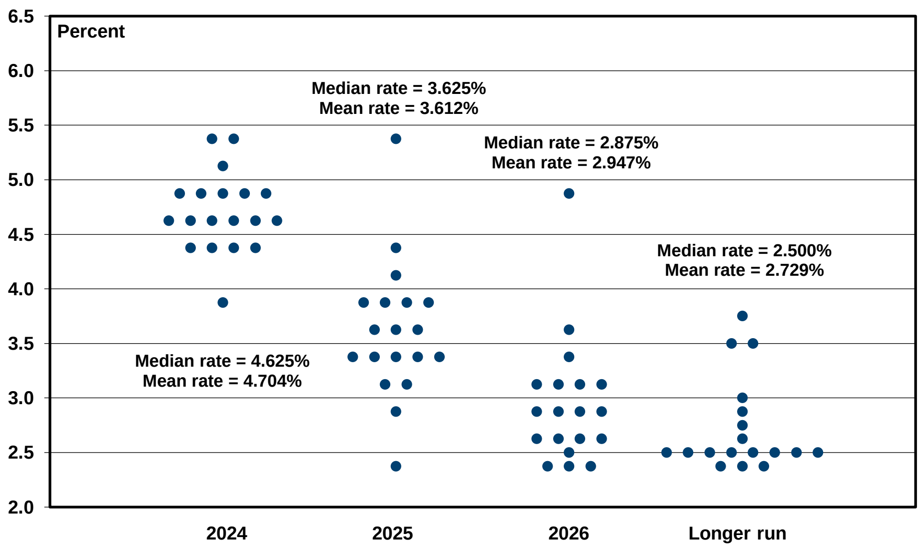
FOMC Rate View, September 2023*



** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*

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

FOMC Rate View, December 2023*



** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*
Source: Federal Open Market Committee, Summary of Economic Projections, December 2023