Daiwa Capital Markets

U.S. FOMC Review

- FOMC: policy rate maintained at a range of 5.25 to 5.50 percent, but statement abandoned its explicit tightening bias
- Powell's press conference: focused on sustainable return to two percent inflation; path of policy contingent on incoming data; March pivot is not the Committee's "base case"
- Quantitative tightening: currently on track in its current permutation; more in-depth discussion of balance-sheet policy to occur in March

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The January FOMC Meeting

The Committee's Statement

The Federal Open Market Committee held steady the target range for the federal funds rate at 5.25 percent to 5.50 percent for the fourth consecutive meeting amid a significant rewrite of the post-meeting statement. That said, while officials dropped language that kept ajar the door to additional hikes (although the target range was last adjusted at the July 2023 FOMC meeting), they maintained a hawkish tilt in the statement by suggesting that a pivot to lower rates is not imminent.

Importantly, the Committee dropped in the January statement its explicit tightening bias, by removing language referring to "the extent of any additional policy firming that may be appropriate to return inflation to 2 percent over time" and instead substituting: "In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks." However, the statement tempered the shift and maintained a hawkish orientation by noting, "The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."

In another shift, the statement retained language acknowledging the Committee's dual mandate of achieving maximum employment and two percent inflation, but it now expressly noted that "risks to achieving its employment and inflation goals are moving into better balance." However, the statement also emphasized: "The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks." Comments by the Fed Chair in his press conference harkened back to this language noting that pandemic effects made forecasting in the current cycle particularly difficult, and that analysis of further data was required to avoid a policy mistake – either easing too early and risking a resurgence in inflation, or maintaining restrictive policy for too long and doing unnecessary damage to the economy.

Other changes to the statement included a revision to the description of economic activity ("expanding at a solid pace" versus "slowed from its strong pace in the third quarter" in the December iteration). In addition, language stating that the banking system remained "sound and resilient" was removed, as was a sentence indicating: "Tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation." We do not view the removal of this verbiage as suggesting intensifying headwinds for the banking sector or a material shift in financial conditions. However, clear guidance on these changes was not offered by Chair Powell in his press conference.

For reference, see the policy statements released at the end of the two most recent meetings: "Federal Reserve issues FOMC statement," Federal Reserve Board, December 13, 2023. https://www.federalreserve.gov/newsevents/pressreleases/monetary20231213a.htm; "Federal Reserve issues FOMC statement," Federal Reserve Board, January 31, 2024. https://www.federalreserve.gov/newsevents/pressreleases/monetary20240131a.htm

Powell's Press Conference

The introductory remarks by Chair Powell followed the broad contours of those at other recent meetings, emphasizing that restoring price stability was an essential goal of the FOMC and that aggressive action on the part of the Committee to achieve that goal left the federal funds rate "well into restrictive territory." On that point, the Chair acknowledged that the policy rate was likely at its peak for the current cycle and that it would probably be reduced at some point later this year. That said, he emphasized the uncertain nature of the outlook and concluded that it would be inappropriate to cut rates before seeing additional evidence that inflation was "moving sustainably back to two percent."

When questioned about the Committee's assessment of inflation developments and asked to provide insight into what would inform policymakers' judgment that inflation had returned "sustainably" to target, Chair Powell acknowledged that significant progress had been made in the past six months and that he and his colleagues were increasingly confident of a favorable outcome. However, he maintained that more evidence was required. He noted that year-over-year growth in the core price index for personal consumption expenditures was still elevated at 2.9 percent (as of December). Later in the press conference, he suggested that while risks on the inflation front were less tilted toward a reacceleration from that vicinity, there still existed a chance that inflation could be sticky at a pace exceeding two percent. Moreover, he further noted that officials would be watching closely revisions to CPI data that will be published on February 9.

While not explicitly stating that a rate cut in March was off the table, Chair Powell implied forcefully that such a move was not the "base case." He reaffirmed the Committee's dependence on the incoming data and argued that data received through today's meeting were unlikely to shift the Committee's thinking by the time of the March meeting. Additionally, he indicated that no decision had been made as to whether a future rate cut would be a "one off" or if it would mark the start of an easing cycle. Again, the evolution of the data would be key in making that assessment.

Although balance sheet policy remained unchanged in January, with the FOMC maintaining redemption caps of $60 billion for Treasury securities and $35 billion for agency mortgage-backed securities, Chair Powell acknowledged that QT could be curtailed in the months ahead. He indicated that the process has gone well thus far, and that some discussion occurred at the January meeting, but he noted that a "more in-depth" review would take place at the March 19-30 policy meeting. Moreover, he suggested that a pivot to lower rates and adjustment to QT would not have to occur in tandem and that balances in the reverse-repurchase facility (RRP) would not have to fall to zero to trigger action.