Daiwa Capital Markets

U.S. FOMC Review

- FOMC: target range for federal funds rate unchanged at 5.25 to 5.50 percent; cuts contingent on inflation developments
- SEP: economic growth in 2024-26 adjusted higher from prior forecast; faster core inflation expected in 2024
- Dot plot: median dot remained at 4.625 percent in 2024; shallower path of cuts anticipated in 2025 and 2026
- Powell press conference: insights on inflation developments and QT

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March FOMC

In a move consistent with previous guidance (and thus widely anticipated), the Federal Open Market Committee left unchanged the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. The latest decision was unanimous, with the March statement almost identical to that released in January. The March statement reiterated that risks to realizing the Committee's "employment and inflation goals are moving into better balance," and importantly reemphasized that rate cuts are predicated on officials gaining "greater confidence that inflation is moving sustainably toward 2 percent." Regarding the lone change to the statement, the March version dropped language in the first paragraph indicating that job gains "have moderated since early last year," instead noting that they "have remained strong."

The new Summary of Economic Projections (SEP) signaled more upbeat views on the economy while anticipating a slower moderation in inflation than indicated in the previous set of forecasts. Regarding output, the median projection for real GDP growth in 2024 was 2.1 percent, up from 1.4 percent in the December 2023 SEP. Expectations for 2025 and 2026 also moved higher (table, below right). Forecasts for inflation suggested stickier core inflation in the near-term, with the median projection for core PCE inflation in 2024 increasing to 2.6 percent from 2.4 percent in the previous SEP. In his press conference, Chair Powell provided some color on the forecast, indicating that the projection for faster inflation reflected near-term developments (brisk CPI & PCE prints for January and a firm CPI reading for February) rather than expectations for slower progress over the balance of the year. However, he was careful to emphasize that additional improvement in inflation was not yet assured.

The new iteration of the dot plot differed from that in December across the forecast horizon, with the new projections suggesting ongoing vigilance in response to much-improved but still brisk-inflation. The median expectation of 75 basis points in easing by year-end 2024 (to 4.625 percent) matched that in December, but the mean increased to 4.809 percent from 4.704 percent. Eighteen officials now projected a year-end rate of 4.625 percent or higher, with nine at the median, whereas only 14 were at or above the median in December (charts, pg. 3). Additionally, the projected year-end medians for 2025 and 2026 were 25 basis points higher than those in December (3.875 percent and 3.125 percent, respectively, versus 3.625 percent and 2.875 percent), with each indicating an additional 75 basis points in cuts. Moreover, the median longer-run dot increased (2.6 percent versus 2.5 percent in December; mean of 2.813 percent versus 2.729 percent). The change, while modest, was notable in that it

Economic Projections of the FOMC, March 2024*

	2024	2025	2026	Longer Run
Change in Real GDP	2.1	2.0	2.0	1.8
Dec. projection	1.4	1.8	1.9	1.8
Unemployment Rate	4.0	4.1	4.0	4.1
Dec. projection	4.1	4.1	4.1	4.1
PCE Inflation	2.4	2.2	2.0	2.0
Dec. projection	2.4	2.1	2.0	2.0
Core PCE Inflation	2.6	2.2	2.0	--
Dec. projection	2.4	2.2	2.0	--
Federal Funds Rate	4.6	3.9	3.1	2.6
Dec. projection	4.6	3.6	2.9	2.5

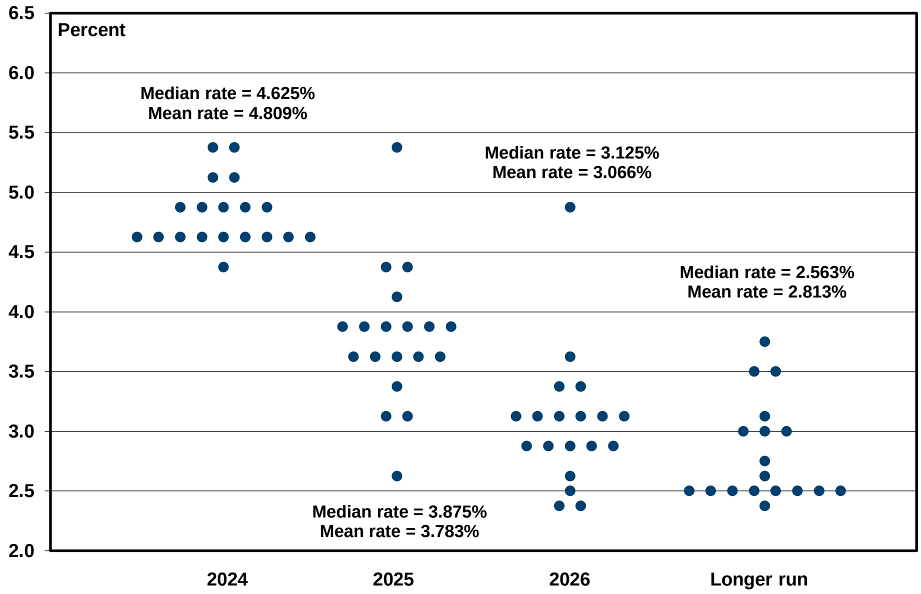
** Median projections*
Source: Federal Open Market Committee, Summary of Economic Projections, March 2024

was the first time the median breached 2.5 percent since March 2019 (2.75 percent). It implied that Fed officials believe r*, the real short-term rate that prevails when the economy is at full employment and inflation is anchored at target, is higher than previously believed. That view also is consistent with a shallower path of rate cuts in the medium term.

In his post-meeting press conference, Chair Powell emphasized that the Committee remained “squarely focused” on its dual mandate. Moreover, he observed that inflation had eased substantially, but that continued progress was not assured. He reiterated that the FOMC does not expect to reduce the target range for the federal funds rate until it gains “greater confidence” that inflation is moving sustainably back to two percent. Shifting from his discussion of the economy and inflation, he indicated that quantitative tightening was discussed at the March meeting and that the Committee was prepared to reduce the pace of balance-sheet runoff “fairly soon.”

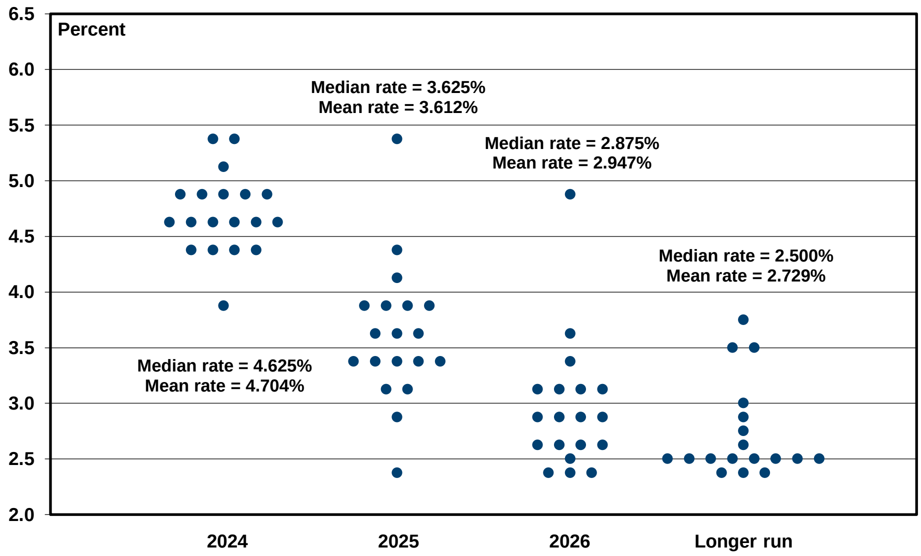
Returning to the economic outlook and inflation developments during the Q&A, the Fed Chair indicated that he believed the target range for the federal funds rate was “well above neutral” (i.e., sufficient to induce further slowing in inflation). Additionally, he indicated that risks at this juncture are two-sided: if the Committee eased too soon, inflation could reaccelerate; at the same time, maintenance of restrictive policy for too long could do unnecessary damage to the economy. With respect to recent brisk inflation prints, he noted that they did not significantly alter his broader view. Inflation is on a “bumpy road” (non-linear trajectory) lower. Specifically with respect to data in the first two months of 2024, Chair Powell suggested that seasonal effects could have influenced the January results; regarding the February CPI, he indicated that while it was firm, it suggested a reading “well below 30 basis points” for the core PCE price index. He neither dismissed the results out of hand, nor was he overly moved by them; he simply argued that ongoing vigilance was required. Moving on from the discussion of inflation, the Fed Chair provided some additional color on plans for balance-sheet policy. While he avoided providing insight into what meeting equated to “fairly soon,” he none-the-less signaled that changes to QT were forthcoming. Importantly, he indicated that near-term plans would focus on slowing Treasury purchases. Longer-term decisions about the composition of the portfolio (i.e., what to do with holdings of agency MBS) and portfolio duration would be made at later. Furthermore, he emphasized that the shift from a regime of “abundant reserves” to “ample reserves” would be done carefully, with caution exercised to avoid disruptions in money markets and spikes in short-term rates. Thus, expect a slowing in Treasury redemptions, with clarifications coming in possibly May or June.

FOMC Rate View, March 2024*



** 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, March 2024

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