

# U.S. FOMC Review

- FOMC minutes: significant progress on inflation, although recent readings firmer than expected
- The Fed's balance sheet: likely upcoming changes to QT
- Staff projections: uncertainty around baseline projections "diminished substantially"
- In light of the March CPI, potential cuts may be delayed further

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## March FOMC Minutes

The minutes from the March meeting of the Federal Open Market Committee noted "significant progress" on inflation, although they acknowledged that readings in the past two months (January and February) "had been firmer than expected." On that point, "a few" participants indicated that "residual seasonality" may have influenced those results, and Committee members generally acknowledged likely "unevenness in monthly inflation readings as inflation returned to target." That said, participants "generally noted their uncertainty about the persistence of high inflation and expressed the view that recent data had not increased their confidence that inflation was moving sustainably down to 2 percent." However, the Committee still reaffirmed that "the policy rate was likely at its peak for this tightening cycle," and that "almost all participants judged that it would be appropriate to move policy to a less restrictive stance at some point this year..." In any case, the policy rate remained "well positioned to respond to economic conditions" if policymakers need to address stickier-than-expected inflation or an unforeseen slowing in economic activity.

As previously indicated by Chair Powell in his post-FOMC press conference, meeting participants "began a discussion" on the broad contours of modifying quantitative tightening, with the "vast majority" assessing that "it would be prudent to begin slowing the pace of runoff fairly soon." Participants indicated that the current process of quantitative tightening "was proceeding smoothly" in the transition from an abundant reserves framework to an ample reserves regime (with the Fed's security holdings declining by ~\$1.5 trillion since the program began in June 2022), although they highlighted the uncertainty surrounding the level of reserves consistent with "ample" and underscored the importance of monitoring money market conditions closely for signs of emerging stress akin to those in September 2019 during the previous (2017-19) episode of balance sheet shrinkage. Regarding adjustments to balance sheet runoff, "participants generally favored reducing the monthly pace...by roughly half." They saw little need to adjust the \$35 billion cap on redemptions of mortgage-backed securities, as redemptions are currently running notably below that cap and officials prefer to return to a Treasuries-only portfolio; thus, adjustments will inevitably occur in the pace of Treasury redemptions (currently capped at \$60 billion per month). Given significant uncertainties, "some participants" reiterated the usefulness of the discount window and standing repo facility as "liquidity backstops" amid the anticipated drain in reserves. In all, comments strongly implied that change will occur soon, with officials acutely aware of potentially emergent stresses in money markets on account of ongoing QT.

Interestingly, Fed staff forecasts seemingly carried a more favorable tone than those of officials. Projections called for below-potential growth in 2024 on account of a restrictive stance of monetary policy. However, near-term expectations were adjusted higher from those in the previous Summary of Economic Projections on account of revised estimates of immigration. Additionally, output in 2025-26 was anticipated to match the economy's potential growth rate (somewhere in the low two-percent area). Additionally, uncertainty around the forecast "was judged to have diminished substantially." Risks to the inflation forecast "were tilted slightly to the upside," while risks to growth "were viewed as skewed a little to the downside." In essence, staff appeared increasingly confident in achieving the desired return to two-percent inflation in the medium term and preventing unnecessary damage to the economy.

In light of today's brisk CPI print (headline and core both up 0.4 percent, with year-over-year advances of 3.5 percent and 3.8 percent, respectively), we cannot help but wonder if the median projection for the target range for the federal funds rate from the March SEP of a reduction of 75 basis points (to 4.625 percent at year-end 2024) will be revised in the new SEP due in June. Several Fed officials have recently signaled favoring one or two reductions of 25 basis points, while others have acknowledged that inflation risks are still tilted to the upside. Achieving further gains against entrenched inflation has proved challenging. To that end, the federal funds rate may have to remain at (or near) its peak for longer.

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