Daiwa Capital Markets

U.S. FOMC Review

- FOMC: content to proceed cautiously
- The June SEP: upward adjustments to inflation and unemployment projections
- Dot plot: 25 basis points of cuts in 2024 amid tight dispersion of projections; view on long-term federal funds rate moves higher
- Powell press conference: timing of first cut, and path of rates, dependent on the totality of the data

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The June FOMC Meeting

As widely expected, the FOMC left unchanged the target range for the federal funds rate at 5.25 to 5.50 percent. Although inflation has improved since a bout of pressure in Q1, including a highly favorable CPI reading for May released earlier today, the latest unanimous vote by the FOMC suggests that officials are content to observe the data for several more months before rethinking the current stance of policy. Indeed, although the Committee maintained its easing bias, Chair Powell indicated in his press conference that officials have yet to gain the required confidence that inflation is moving back to the two-percent target on a sustainable basis (although conditions for gaining that confidence may be met later this year).

The Committee's post-meeting statement was substantially similar to other recent iterations, which noted that "risks to achieving its employment and inflation goals have moved toward better balance over the past year," and that policymakers remain "highly attentive to inflation risks." With that in mind, the statement did offer a more favorable assessment of inflation than the May 1 version, with the first paragraph indicating: "In recent months, there has been modest further progress toward the Committee's 2 percent inflation objective," while the previous statement cited "a lack of further progress."

The new Summary of Economic Projections (SEP) contained several changes with respect to projections for the expected path of the federal funds rate and key economic variables (table). Regarding the target range for the federal funds rate, the median expectation for 2024 (perhaps the most notable change) rose to 5.125 percent in June from 4.625 percent in March – implying a reduction of 25 basis points by year-end rather than 75 in the previous projection (charts, next page). Additionally, a somewhat faster pace of cutting was implied for 2025 (100 basis points versus 75 basis points in March), although the expected year-end rate of 4.125 percent was a bit higher than previously forecast (3.875 percent in March). Policymakers, however, still forecast a year-end 2026 rate of 3.125 percent.

The shift in the dot plot, and upward revision to inflation forecasts, was attributable to resurgent inflation in Q1 before the most recent easing indicated in the May CPI report. In the latest SEP, the median expectation for headline PCE inflation in 2024 increased to 2.6 percent from 2.4 percent as of March, and the median for 2025 increased by 0.1 percentage point to 2.3 percent. The median expectation for the core PCE index in 2024 jumped to 2.8 percent from 2.6 percent before moderating to 2.3 percent in 2025 (versus an expected pace of 2.2 percent as of March). Forecasts for 2026 and in the longer run were unchanged from the previous SEP. Offering some insight into the forecasts, Chair Powell suggested that they were "conservative," but they did not necessarily imply that policymakers believed the

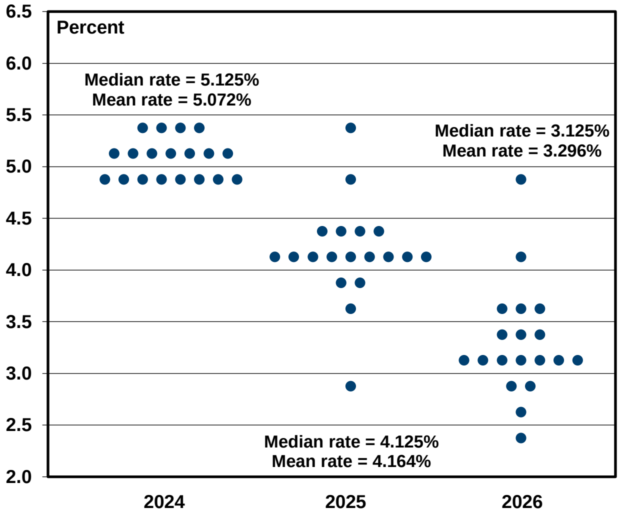
Economic Projections of the FOMC, June 2024*

	2024	2025	2026	Longer Run
Change in Real GDP	2.1	2.0	2.0	1.8
Mar. projection	2.1	2.0	2.0	1.8
Unemployment Rate	4.0	4.2	4.1	4.2
Mar. projection	4.0	4.1	4.0	4.1
PCE Inflation	2.6	2.3	2.0	2.0
Mar. projection	2.4	2.2	2.0	2.0
Core PCE Inflation	2.8	2.3	2.0	--
Mar. projection	2.6	2.2	2.0	--
Federal Funds Rate	5.1	4.1	3.1	2.8
Mar. projection	4.6	3.9	3.1	2.6

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

outlook to be worsening. Regarding other elements of the forecast, officials maintained expectations for GDP growth of 2.1 percent this year and 2.0 percent in 2025, although the unemployment rate could peak at 4.2 percent next year rather than the previously assumed 4.1 percent (table, previous page). The longer run estimate of the unemployment rate also was nudged higher to 4.2 percent (versus 4.1 percent as of March).

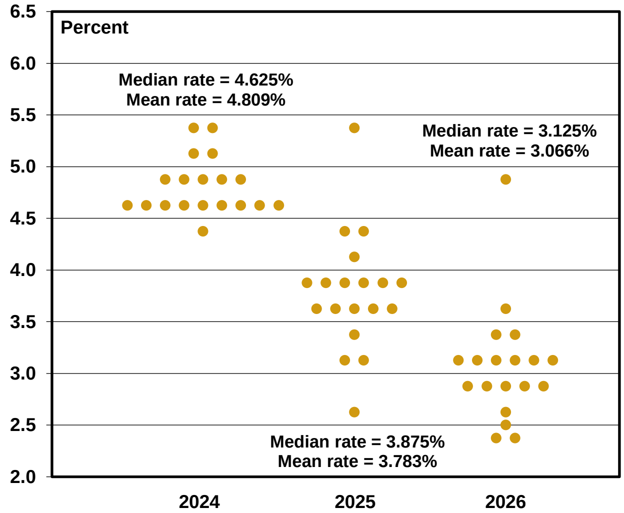
FOMC Rate View, June 2024*



** 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, June 2024

FOMC Rate View, March 2024*

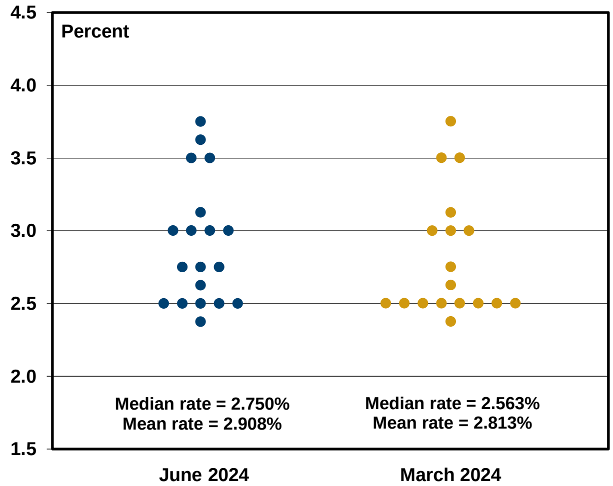


** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*

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

We had suspected that expectations for the longer run federal funds rate would move higher in June, as there has been a good deal of discussion concerning the resilience of the U.S. economy and the responses of growth and inflation to the current policy setting. This view was ratified by the shift in the June SEP, as the median increased to 2.750 percent from 2.563 percent in March and the mean rose to 2.908 percent from 2.813 percent (chart, right). That projection implies a higher r* (real neutral rate) than what prevailed earlier in the pandemic period. When asked about the higher longer run rate in his press conference, Chair Powell pushed back against its near-term utility. He referred to r*, which can be inferred from views on the long-run nominal rate, as a “theoretical construct” that didn’t factor much into the discussion of the current policy setting. Moreover, he took the opportunity to emphasize that the level of the federal funds rate is “restrictive.” Even so, his comments are unlikely to put to rest discussion regarding the amount of restraint monetary policy is having on the economy, particularly as growth remains solid, inflation is expected to recede slowly, and various measures of financial conditions have eased notably in 2024 thus far.

FOMC Rate View, Longer Run*



** Each dot represents the expected longer run level of the federal funds rate of a Fed official.*

Source: Federal Open Market Committee, Summary of Economic Projections, March 2024 & June 2024

Beyond his discussion of the upward adjustment to inflation forecasts, Chair Powell offered a few additional insights in his press conference. First, while declining to give specific numbers, he did concede that “most” officials did not revise forecasts after reviewing this morning’s CPI report. Also, he suggested that two rate cuts this year was a “plausible” outcome, even with the median dot indicating one cut. Critically, he emphasized that any move will be dependent on the “totality of the data,” a view that he has repeated time and again. That said, we viewed his tone as generally favorable; to this end, the Fed Chair appeared cautiously optimistic that inflation objectives can be achieved while maintaining a solid performance in the economy.