Daiwa Capital Markets

U.S. FOMC Review

- FOMC: no change in policy at the July meeting, but door open to a rate cut in September
- Policymakers "attentive" to risks to both sides of the dual mandate

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The July FOMC Meeting

The Federal Open Market Committee voted unanimously today to leave the target range for the federal funds rate unchanged at 5.25 to 5.50 percent. The move ratified market expectations for no change in policy at this meeting while setting up a potential move at the September 17-18 gathering. The next few months will be a pivotal period for the FOMC. The inflation data are trending in the right direction and, according to assessments of the Fed Chair and colleagues, labor market conditions are akin to the highly favorable 2018-19 period preceding the COVID pandemic. Upcoming decisions by the Committee will either assist in engineering a soft landing for the economy or contribute to potentially undesirable outcomes – in particular, unnecessary deterioration in the labor market generated by maintaining a restrictive stance of policy for too long, or allowing for a resurgence in inflation by pivoting too early.

Notable changes to today's policy statement, in our view, broadly aligned with recent statements by Fed officials in capturing changes in the economic landscape and recharacterizing the balance of risks. With regard to the economy, the first paragraph of the latest FOMC statement reiterated that "economic activity has continued to expand at a solid pace," but it noted that job gains "have moderated" rather than "remained strong." Additionally, with regard to the employment situation, the new iteration indicated that the unemployment rate "has moved up but remains low" rather than simply "remained low" as described in June. On the inflation front, the July statement noted that inflation remains "somewhat elevated" (versus simply "elevated") and that there has been "some further progress" rather than "modest further progress" towards the Committee's inflation objective. The changes were subtle, but along with Chair Powell's post-meeting comments that emphasized a broadening in the disinflationary process, we interpret them as suggesting more substantial headway made in returning inflation to two percent. Shifting to the second paragraph, the new statement indicated that "risks to achieving its employment and inflation goals continue to move into better balance," and that "the Committee is attentive to the risks on both sides of its dual mandate." The previous statement noted that "risks…have moved into better balance over the past year," and "the Committee remains highly attentive to inflation risks." In other words, risks to both the employment and inflation mandates are approximately in balance and policymakers need be attentive to both henceforth. (For a more complete view of the changes in context, see the partial statement comparison on page 2.)

We viewed Chair Powell's press conference as more telling of the Committee's intentions than the statement. While the Fed Chair maintained that no decision has been made concerning the September meeting, and that policy setting remains contingent on the incoming data, he did concede that policymakers viewed recent price data as favorable – even better than that seen in the second half of last year – and that poor results in Q1 were increasingly viewed as the outlier. Specifically, he highlighted broadening in disinflation in Q2 beyond that seen in goods prices in 2023-H2 that now includes better readings in housing services and core services prices excluding housing. He further indicated that recent results gave participants greater confidence that inflation was on a more sustainable track, and he implied that inflation readings between now and September could add meaningfully to increasing that confidence (and possibly tip the scales in favor of a cut). Regarding the labor market, Chair Powell emphasized that he viewed it as in a good place. Moreover, he argued that he no longer viewed labor market conditions as a contributory factor to inflationary pressure. With that said, he seemed keenly aware that the labor market could respond on an ongoing basis to the lagged effects of restrictive policy, and he appeared poised to react if it starts softening in an undesirable fashion. In that regard, he noted that policy is "well positioned" to address both upside risks to inflation and downside risks to labor market conditions. While staying on message, the Fed Chair also made two additional interesting points. First, he said flatly that policymakers were "not thinking about" a 50-basis-point cut in September (before reiterating that no decisions had been made regarding September). The exchange, in our view, affirmed the Committee's implicit bias toward cutting but also suggested that it would follow an orderly path. In that regard, we found the second interesting point to be that Chair Powell saw the chance of a hard landing as "low." Thus, policymakers are close to achieving their inflation and employment objectives and will be proceeding carefully.

FOMC Statement Comparison*

July 31, 2024 FOMC Statement (In Part)

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have **moderated**, and the unemployment rate has **moved up but remains low**. Inflation has eased over the past year but remains **somewhat elevated**. In recent months, there has been **some** further progress toward the Committee's 2 percent inflation objective.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals **continue to move into better balance**. The economic outlook is uncertain, and the Committee **is attentive to the risks to both sides of its dual mandate**.

June 12, 2024 FOMC Statement (In Part)

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have **remained strong**, and the unemployment rate has **remained low**. Inflation has eased over the past year but remains **elevated**. In recent months, there has been **modest** further progress toward the Committee's 2 percent inflation objective.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals **have moved toward better balance over the past year**. The economic outlook is uncertain, and the Committee **remains highly attentive to inflation risks**.

** Changes from statement to statement shown in bold.*
Source: Federal Open Market Committee; Daiwa Capital Markets America