Daiwa Capital Markets

U.S. FOMC Review

- FOMC: 25 basis point cut; one policymaker dissents, with preference for no change in the FFR
- The December SEP: slower deceleration in inflation; firmer growth
- Dot plot: shallower path of cuts; median view on longer-term rate at 3.0 percent
- Powell press conference: uncertainty around inflation suggests that Committee should proceed "carefully"

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The December FOMC

The FOMC reduced the target range for the federal funds rate by 25 basis points to 4-1/4 to 4-1/2 percent at its December meeting, a result widely anticipated by market participants. The shift marked the third consecutive cut, with the cumulative change of -100 basis points pushing the policy rate closer to what Chair Powell characterized in his press conference as "significantly less restrictive" but nonetheless still well positioned to address both upside risks to inflation and downside risks to the labor market. More surprising were adjustments to the new set of FOMC forecasts, as the December Summary of Economic Projections suggested a shallower path of rate cuts vis-à-vis the September iteration in response to a slower retreat in inflation than previously anticipated. In fact, the latest assessments likely contributed to a dissent from the Committee action, with Beth M. Hammack, the President of the Cleveland Fed, voting in favor of maintaining the target range for the federal funds rate at 4-1/2 to 4-3/4 percent.

The Committee's statement was broadly similar to that from November, noting that the economy expanded "at a solid pace," that "the unemployment rate has moved up but remains low," and that inflation "has made progress toward the Committee's 2 percent objective but remains somewhat elevated." Additionally, risks to the inflation and employment goals remained "roughly in balance." The third paragraph, however, contained a somewhat subtle change. The new statement indicated: "In considering ***the extent and timing*** of additional 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." The previous statement, in contrast, excluded the bolded text (our emphasis). When asked in his press conference if the change portended an extended pause in rate cuts, Chair Powell instead emphasized that the Committee was in a place where it would slow adjustments and that future cuts to the target range were contingent on the evolution of the data relative to policymaker projections.

With respect to monetary policy implementation, the Board of Governors moved to lower the interest rate paid on reserve balances to 4.4 percent from 4.65 percent in November. Additionally, the bid/offer rates for overnight repurchase agreement operations were lowered from 4.75 percent and 4.55 percent, respectively, to 4.5 percent and 4.25 percent. The prospect of this technical adjustment was raised in the November FOMC minutes. Beyond administered rates, QT was left unaltered, with the redemption cap for maturing Treasury securities maintained at $25 billion per month, along with $35 billion for agency debt and agency mortgage-backed securities.

Economic Projections of the FOMC, December 2024*

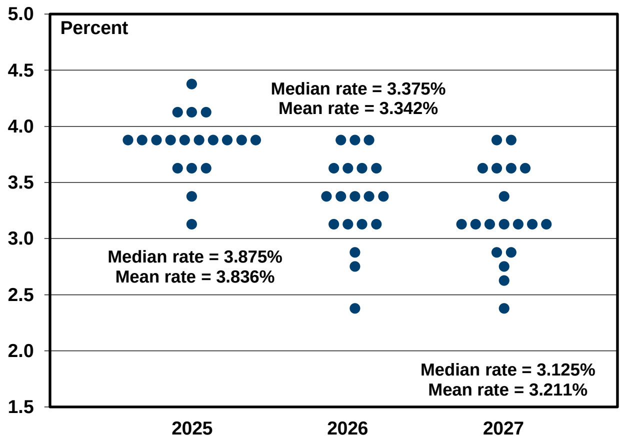
	2024	2025	2026	2027	Longer Run
Change in Real GDP	2.5	2.1	2.0	1.9	1.8
Sep. projection	2.0	2.0	2.0	2.0	1.8
Unemployment Rate	4.2	4.3	4.3	4.3	4.2
Sep. projection	4.4	4.4	4.3	4.2	4.2
PCE Inflation	2.4	2.5	2.1	2.0	2.0
Sep. projection	2.3	2.1	2.0	2.0	2.0
Core PCE Inflation	2.8	2.5	2.2	2.0	--
Sep. projection	2.6	2.2	2.0	2.0	--
Federal Funds Rate	4.4	3.9	3.4	3.1	3.0
Sep. projection	4.4	3.4	2.9	2.9	2.9

** Median projections*

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

As noted above, the new SEP contained several noteworthy changes, particularly with respect to inflation and the labor market (table, prior page). Regarding inflation, both median projections for the headline price index for personal consumption expenditures and the core measure were adjusted higher over the forecast horizon, with a return to 2.0 percent inflation now anticipated in 2027 rather than 2026. Additionally, the unemployment rate is now expected to peak at 4.3 percent in 2025 (versus 4.4 percent, prior) and remain at that level through 2027. Near-term growth also was adjusted higher, with Chair Powell describing the economy as “remarkable” when responding to a question.

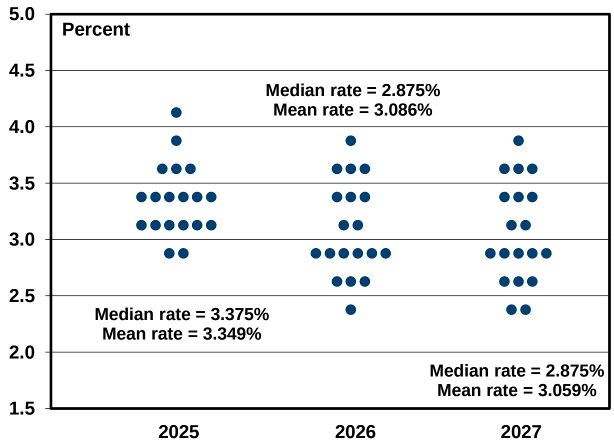
FOMC Rate View, December 2024*



** 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, December 2024

FOMC Rate View, September 2024*

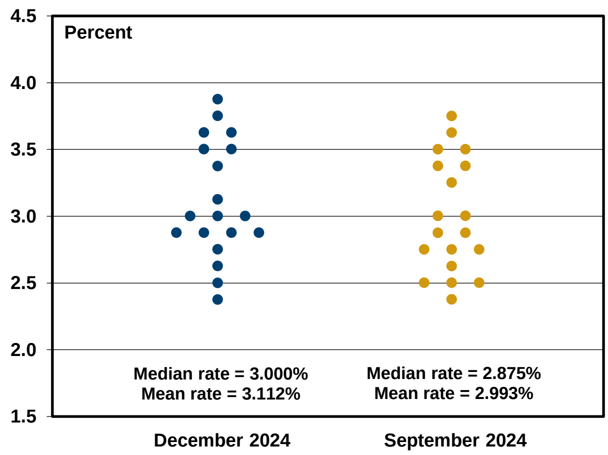


** Each dot represents the expected federal funds rate of a Fed official at the end of the year.*

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

The projected path of policy also was adjusted, particularly in light of the recent price data and expectations for a slow ongoing moderation in inflation. The median expectation for the path of policy was shallower than that in September, with the median dot for 2025 of 3.875 percent 50 basis points higher than that in the prior SEP. Year-end projections for 2026 and 2027 also rose (3.375 percent and 3.125 percent, respectively, versus 2.875 percent for both years in the prior SEP; charts, above). Additionally, the median estimate for the longer run federal funds rate rose to 3.000 percent from 2.875 percent, supporting the ongoing assessment of various Fed officials that r* (that is, the long-term neutral rate) has increased from the recent low. With that said, the range of estimates for the longer run rate remained wide in December (2.375 percent to 3.875 percent; chart, right).

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, September 2024 & December 2024

The majority of Chair Powell’s press conference dealt with labor market developments and inflation. With respect to the labor market, he noted that conditions were still cooling, and looser than they were in 2019, but that downside risks had diminished. Additionally, he indicated that labor market conditions, and by extension wage growth, were no longer contributing meaningfully to undesirable inflation pressure. However, Powell appeared a bit more concerned about inflation. When questioned as to whether monetary policy was in the recalibration phase, he noted that that portion of the process had passed, as the federal funds rate was now significantly closer to neutral -- although still somewhat restrictive. Henceforth, policymakers would proceed carefully, with further cuts contingent on inflation showing progress toward the 2 percent target. At the same time, he seemed to hedge his hawkish remarks. He indicated that he was confident that inflation would return to 2 percent, and that pressure in service prices (both for housing and non-housing services) was tied to previous shocks in the 2021-22 period that will continue to unwind over time. With that said, Powell and colleagues appear less certain about the near-term path of policy and will exercise caution with respect to inflation. Indeed, this caution is further justified as policies from the incoming Trump administration (e.g., tariffs) could potentially induce inflationary pressure next year.