Daiwa Capital Markets

U.S. FOMC Review

- FOMC: policymakers act unanimously, leaving unchanged the federal funds rate for the third consecutive meeting -- a move in line with market expectations
- Policy statement: risks to both sides of the dual mandate "have risen"
- Powell press conference: monetary policy "in a good place;" Committee awaiting "further clarity," as the costs of waiting are "fairly low"

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The May FOMC Meeting

The Federal Open Market Committee left unchanged the target range for the federal funds rate at 4-1/4 to 4-1/2 percent for the third consecutive meeting, a move ratifying nearly unanimous market expectations implied by futures pricing. Various policy initiatives of the Trump administration have introduced significant uncertainty into the economic outlook (although they have yet to meaningfully alter the path of the economy or the trajectory of underlying inflation), therefore convincing policymakers that patience is the best approach at this juncture. In particular, policy shifts on the trade front (tariffs) have exacerbated risks to both sides of the dual mandate and raised the possibility of uncomfortable tradeoffs should the Committee have to confront both rising unemployment and accelerating inflation in coming months. Acknowledging these risks -- and lack of actionable information at this time -- all participants voted in favor of the latest policy action.

The May FOMC statement included several changes that reiterated that the U.S. economy remained resilient, while also capturing the heightened uncertainty – sentiments that served as a foundation for Chair Powell's press conference. The first paragraph acknowledged that "swings in net exports have affected the data," but it reiterated that "economic activity has continued to expand at a solid pace." Perhaps more consequential was the acknowledgement in paragraph two indicating that, "Uncertainty about the economic outlook has increased further" (versus just "increased," previously), which underscored the difficulty in policymaking in the current environment. Additionally, the latest statement retained language that the "Committee is attentive to the risks to both sides of its dual mandate," but it added that it "judges that the risks of higher unemployment and higher inflation have risen." Preceding the press conference, we viewed the inclusion of this verbiage as suggesting that the Committee is considering the possibility of a stagflation scenario more seriously than it had previously, but later remarks by the Fed Chair steered clear of validating our view.

Turning to the post-meeting press conference, Chair Powell utilized his opening remarks to note the resilience of the U.S. economy and labor market while reiterating the ongoing moderation in underlying inflation. With that said, he reminded attendees that shifts in focus introduced by the Trump administration relating to trade/tariffs, fiscal policy, immigration policy, and regulatory policy has the potential to alter the economic outlook. Notably, the implementation of reciprocal tariffs on April 2nd (with some postponed for 90 days to early July) had the potential, if sustained, to exacerbate upside risks to inflation and unemployment and downside risks to growth. Despite focus on risks associated with trade policy, Chair Powell refrained from offering guidance on how officials could respond to various scenarios, emphasizing how uncertainty surrounding the path of the economy is "extremely elevated." Rather, he stressed that a mild to moderately restrictive policy setting left the Committee in "a good place as we await further clarity," and he further argued further that "the costs of waiting were fairly low" – language suggesting that he was content to gather further information rather than rush to preempt developments that might never materialize. With that said, we did find interesting an observation wherein Chair Powell drew a distinction between the current episode and that in 2019 when the FOMC cut the federal funds rate by 75 basis points between August and October over concern that trade tensions would slow economic growth. In analyzing that situation, he stressed that inflation at the time was below the Fed's 2 percent objective – a distinctly different scenario than what exists currently. We read this differentiation as suggesting that Powell and colleagues, despite noting increased risks to both sides of the dual mandate, are still concerned about tariffs reverberating through the economy beyond an initial increase in price levels (so-called second-round effects that could materialize if inflation expectations become unanchored). Thus, we suspect that policymakers could possibly respond more slowly to softening labor market conditions than some market participants currently expect.

Ultimately, we still view possible reductions in interest rates as unlikely to materialize in the next month or so. With unemployment currently low at 4.2 percent and the brunt of tariffs only coming into force in the summer, we suspect that officials will maintain their current stance for some time. Should tariff-related inflation remain contained to prices of goods, and longer-term inflation expectations remain anchored, cuts could more possibly resume in September to support the economy (with an additional reduction of 25 basis points in December and further easing of 50 basis points in 2026-H1). Then again, should current levies be reduced through negotiation, we could foresee more rapid reductions towards neutral. Again, time will tell – and officials believe that policy is calibrated to allow for patience.

FOMC Statement Comparison*

May 7, 2025 FOMC Statement

Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty **about** the economic outlook has increased **further**. The Committee is attentive to the risks to both sides of its dual mandate **and judges that the risks of higher unemployment and higher inflation have risen**.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. 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 Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; **Neel Kashkari**; Adriana D. Kugler; Alberto G. Musalem; and **Christopher J. Waller**. **Neel Kashkari voted as an alternate member at this meeting**.

March 19, 2025 FOMC Statement

Recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty **around** the economic outlook has increased. The Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. 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 Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. **Beginning in April, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $25 billion to $5 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion**. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

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