May 1, 2024

Less dovish? Yes. Hawkish? No.

By Taylor Schleich & Warren Lovely

Rate Statement

As anticipated, the FOMC voted to leave the target range for the federal funds rate unchanged at 5.25% to 5.50%. This was the sixth consecutive stand pat decision, all of which have been unanimous. Meanwhile, the well-telegraphed QT taper was formally announced and will be starting next month. In June, the Fed will begin reducing its Treasury holdings by up to $25 billion/month (previously $60 billion/month) and agency MBS holdings by up to $35 billion/month (unchanged). Principal payments in excess of the MBS cap will be invested into Treasuries.

When it comes to the brief economic assessment, the statement notes the economy continued to expand at a solid pace, job gains remained strong and the unemployment rate remained low. Not surprisingly, there was a material change made to the characterization of inflation:

- March 20th: "Inflation has eased over the past year but remains elevated."
- May 1st: "Inflation has eased over the past year but remains elevated. <u>In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective.</u>"

Despite this consistently hotter-than-expected inflation in 2024 the forward-looking segment of the statement was left untouched, the Fed's clear cutting bias maintained:

- "In considering any 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 does not expect it will be appropriate to <u>reduce the target range</u> until it has gained greater confidence that inflation is moving sustainably toward 2 percent."

Selected takeaways from the press conference

To cut to the chase, the tone of the press conference was far less hawkish than had been feared (or priced based on the market's reaction). Powell readily conceded that inflation has been higher than expected, that he's less confident in the inflation outlook and that it's going to take longer to gain the confidence needed to lower rates. They'll hold policy here as long as necessary. However, he also made it clear that the story the Fed has been advancing is still alive: Inflation should moderate over the balance of the year because of a policy stance that is still judged to be sufficiently restrictive.

On more than one occasion, Powell was asked about the potential for future rate hikes. He consistently downplayed the risk of this scenario, calling it "unlikely". Instead, the main paths are towards cutting and towards holding at the current level. Which path they take will of course depend on the data. We'd note that the Fed Chair stressed that inflation isn't the only factor they need to consider. While an easing in price pressures could lead them to cut, so too could an unexpected softening in labour market conditions. It's not the first time we've heard this from him. While job growth has remained strong this year, Powell highlighted that labour demand has cooled significantly by a number of measures (quits rate, job openings, business and consumer surveys).

Bottom Line

Going into the decision, we didn't expect much to change in the statement other than an acknowledgement that inflation has been hotter than expected of late. Indeed, the statement added such language. Meanwhile, retaining a cutting bias in the forward-looking component of the statement is an indication that the FOMC is not totally throwing in the towel on the narrative that inflation will gradually ease towards target and rate cuts will become appropriate. In that sense, the decision—at least the rate statement component—was as expected. However, the big wildcard for the meeting was always going to be about the press conference and the tone Chair Powell would strike. And here, his stance was far less hawkish than many had feared. While Powell conceded that price pressures have been stronger than expected and there's more uncertainty on the inflation outlook, he still believes policy is sufficiently restrictive which should lead to moderating inflation over the balance of the year. Therefore, it's 'unlikely' that further tightening will be appropriate. Importantly, the Fed Chair is not losing sight of the labour market. Given his sensitivity to this side of the mandate, there is still plenty of scope for rate cuts this year if/when conditions soften. And in Powell's defense, there are a long list of signs that labour market conditions *are* easing, even if headline employment continues to grow at a robust pace. As a result, we still expect 50 basis points of rate cuts this year, with weaker job market data helping to provide a catalyst to start the easing process.

Finally, as it relates to balance sheet policy, the Fed announced the taper that it had pretty clearly telegraphed over recent months. The new pace of run-off is a bit smaller than was broadly anticipated but $5 billion/month of less run-off shouldn't materially impact yields.

Fed's statement (May 1, 2024):

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 a lack of 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.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 5-1/4 to 5-1/2 percent. In considering any 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 does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. Beginning in June, the Committee will slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from $60 billion to $25 billion. The Committee will maintain the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion and will reinvest any principal payments in excess of this cap into Treasury securities. The Committee is strongly committed to 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; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; Loretta J. Mester; and Christopher J. Waller.

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