Fed Policy Monitor

Economics and Strategy

NATIONAL BANK OF CANADA
FINANCIAL MARKETS

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Dot drift gives rates a lift

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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 seventh consecutive stand pat decision, all of which have been unanimous. Consistent with the announcement in May, the Fed reiterated it is now reducing its Treasury holdings by up to $25 billion/month and agency MBS holdings by up to $35 billion/month. Principal payments in excess of the MBS cap will be invested into Treasuries.

When it comes to the brief economic assessment, the statement reiterates that the economy is still expanding at a "solid pace", job gains remain "strong", and the unemployment rate remains "low". There was, however, an adjustment made to the inflation characterization:

- **May 1st:** "In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective."
- **June 12th:** "In recent months, there has been modest further progress toward the Committee's 2 percent inflation objective."

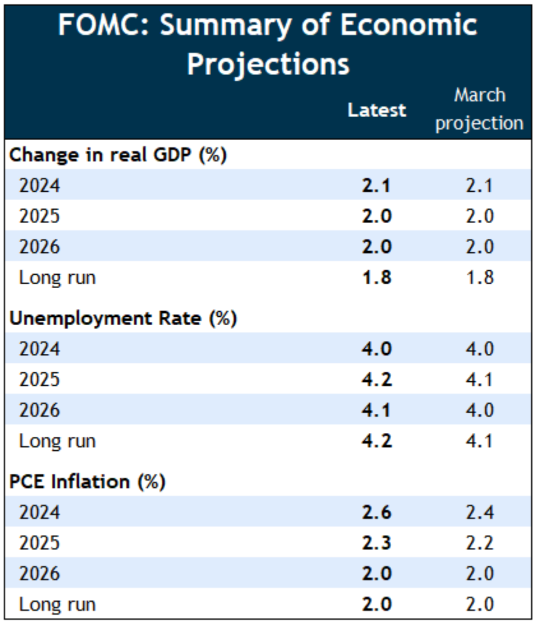
Meanwhile, the forward-looking segment of the statement was left untouched, the Fed's cutting bias maintained:

- "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 reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent"

Summary of Economic Projections:

As always, the publication of an updated dot plot attracted a lot of attention. More than anything, the market was keen to see the extent to which FOMC expectations for rate cuts had been altered by the latest economic data. The answer to that question is: more than some might have expected following the release of May's CPI. The median 2024 dot showed only one rate cut, two fewer than had been penciled in back in March and one fewer than what forecasters had expected. FOMC members still anticipated an acceleration of monetary policy easing in 2025, but nonetheless saw the policy rate ending the year slightly higher than three months ago (at 4.125% instead of 3.875%). Rates were then expected to go down to 3.125% at the end of 2026, unchanged from March. It's also worth noting, the median estimate of the "longer run" rate rose from 2.56% to 2.75%. This development doesn't come as a huge surprise as upward 'drift' had been underway in earlier iterations of the dot plot.

The Summary of Economic Projections (SEP) showed no revision to the growth outlook, with GDP still forecast to grow by 2.1% in 2024 and 2.0% in 2025 and 2026. The unemployment rate forecast, for its part, was revised slightly upwards in both 2025 and 2026, moving from 4.1% to 4.2% and from 4.0% to 4.1%, respectively. Notably, policymakers expect unemployment to hold steady at 4% for the balance of this year. Supporting the upward shift in the dots, the headline and core PCE inflation outlook was marked up 0.2% in 2024 and 0.1% in 2025.



FOMC: Summary of Economic Projections

	Latest	March projection
Change in real GDP (%)		
2024	**2.1**	2.1
2025	**2.0**	2.0
2026	**2.0**	2.0
Long run	**1.8**	1.8
Unemployment Rate (%)		
2024	**4.0**	4.0
2025	**4.2**	4.1
2026	**4.1**	4.0
Long run	**4.2**	4.1
PCE Inflation (%)		
2024	**2.6**	2.4
2025	**2.3**	2.2
2026	**2.0**	2.0
Long run	**2.0**	2.0

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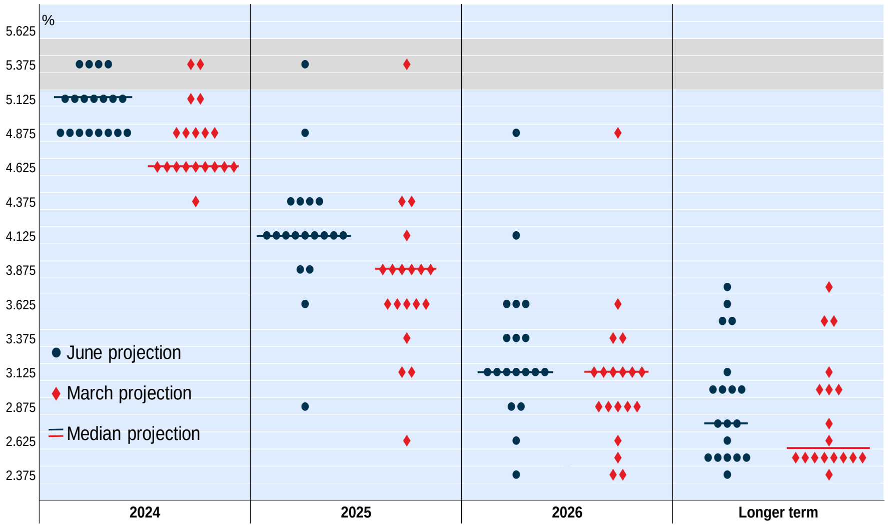
U.S.: FOMC participants' assessment of appropriate monetary policy

Current target range: 5.25%-5.50% (grey area)



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Press Conference:

Markets interpreted the press conference as marginally hawkish, front-end yields grinding up as Powell spoke. However, we wouldn't completely agree with that assessment and instead see it as largely neutral. Not surprisingly, data dependence was mentioned innumerably as the Fed Chair stressed they'd need further progress on inflation. Today's CPI data was welcomed and very encouraging but they "need to see more good data". Importantly, he was asked if Fed officials updated their projections in light of this morning's information. He noted that they have the opportunity to do so: "Some people do, some don't. *Most people don't*". It's therefore possible FOMC projections may have looked a bit different had the data come out earlier. To that point, he stressed that decisions on the SEPs are "very close calls" and all outlooks laid out in the dot plot are "plausible scenarios". We also heard him push back on questions implying the rate outlook has materially changed. He noted that cuts have just moved later but end of year levels in future years don't look too dissimilar from March's dots.

When it comes to the committee's outlook for inflation, some journalists noted that their forecasts imply little further progress this year. Powell said that's partly to do with base effects but added that they've made "conservative" forecasts with "good but not great" readings. To water down their assessment further, he said they don't have a "high degree of conviction" that this assessment is correct.

As always, we were focused closely on Powell's discussion of the labour market. He noted that conditions have broadly returned to where they were pre-pandemic but emphasized that it's still a strong market. They see that strength continuing but that they're watching developments here "very carefully". As for wages, he pointed to the moderation from peak pressures but admitted that they "are still running above a sustainable path".

Bottom Line:

An updated dot plot revealed most Fed officials see either no change to policy this year or just a single rate cut, a somewhat surprising development. Without meaning to downplay this shift, we'd note that the change in the *median* year-end rate expectation (+50 bps) is significantly more than the change in the *average* year-end expectation (+26 bps). Put differently, there's still a fair number of Fed officials in the "two cut" camp (8 of 19, to be exact). While dot plot changes sent yields up a handful of basis points and the Powell presser saw them rise further, we're still left non-trivially lower on the day after this morning's *very soft* CPI report. Indeed, it appears that markets are somewhat skeptical that the Fed will be able to make it through the year easing policy rates just once. After the dust settled, there's still some 40 basis points of easing priced for 2024.

We too would assess that risks are skewed to more easing rather than less, particularly after seeing the tepid price pressures in this morning's release. (As an aside, it's entirely possible the dot plot would look a bit less hawkish had Fed officials been given more time to assess the data and fully incorporate it into their projections.) A jobless rate that's been gradually rising and a consumer that appears to be slowing down also suggests there could be scope for two cuts this year. That brings us to the Fed's other economic projections. Policymakers have assumed that the economy remains rock solid this year. They see the steady rise in the jobless rate halting and growth remaining strong into the end of year. We disagree on both of these fronts. Should the data released over coming months come closer in line with our expectations, it's possible that the next iteration of the dot plot could add a cut back in.

The Fed's next decision will take place on July 31st. The minutes for today's meeting will be published on July 3rd.

Here is the interest rate statement:

Federal Reserve issues FOMC statement

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.

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. 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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