

Macro Note

US Jan 2020 FOMC: Policy Steady But Fed's Not Happy With Inflation

Thursday, 30 January 2020

Alvin Liew

Senior Economist

Alvin.LiewTS@uobgroup.com

- The Federal Reserve as widely expected, kept its policy Fed Funds Target Rate (FFTR) unchanged at the range of 1.50-1.75% at the 28/29 January 2020 Federal Open Market Committee (FOMC) meeting with a unanimous decision (10-0).
- The FOMC statement had two highlights; 1) the Committee “*judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation returning to* [from “near” in the December 2019 FOMC] and 2) the downgrade of US household spending which “*has been rising at a moderate pace*” [from “a strong pace” in the December 2019 FOMC].
- FOMC Chair Jerome Powell later explained during his post-FOMC press conference that the change in inflation language in the FOMC policy statement reflected the need for a clear signal that the Fed does not want inflation persistently below 2%, with Powell emphasizing the Fed’s dissatisfaction with inflation running below 2%.
- In contrast to the market view of a more prolonged Fed pause, **we still expect the Fed to implement the next 25bps rate cut in 1Q 2020 at the March FOMC** as another insurance cut in view of the potential risks of US trade policy, Middle East geopolitical tensions and the latest being the coronavirus outbreak in China. Conversely, if all these risk factors do not materialize, then the “insurance” cut will be unnecessary. The view remains for the Fed Reserve to keep policy rates low or even lower in 2020.

Keeping Policy Steady But The Fed Is Dissatisfied With Persistently Low Inflation

As widely expected, the Federal Reserve (Fed) kept its policy Fed Funds Target Rate (FFTR) unchanged at the range of 1.50-1.75% at the 28/29 January 2020 Federal Open Market Committee (FOMC) meeting. This was the second straight FOMC that garnered a unanimous decision (10-0).

In an [accompanying Implementation note](#), the FOMC also decided to increase the interest paid on excess reserves (IOER) by 5bps to 1.60%, which will now be 10bps above the bottom of the FFTR range. The FOMC also decided to continue to buy US Treasury bills at least into 2Q 2020 “*to maintain over time ample reserve balances at or above the level that prevailed in early September 2019*” and to continue conducting term and overnight repurchase agreement operations at least through April (2020) and will be conducted at an offering rate of 1.50% (which was increased by 5bps as well, from 1.45% previously).

As for the FOMC statement, there were two main highlights even though the Fed kept the benchmark rates steady. The first was that the Committee “*judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation returning to* [from “near” in the December 2019 FOMC] *the Committee’s symmetric 2 percent objective.*” FOMC Chair Jerome Powell later explained during his post-FOMC press conference that the change in inflation language in the FOMC policy statement reflected the need for a clear signal that the Fed does not want inflation persistently below 2%. Powell emphasized that the Fed is not satisfied with inflation running below 2%, it is not a ceiling and that the Fed is determined to avoid inflation persistently running below 2%.

The second highlight was the downgrade of US household spending which “*has been rising at a moderate pace*” [from “a strong pace” in the December 2019 FOMC]. The Fed’s outlook for the rest of the US economic variables were unchanged as it reiterated “*the labor market remains strong and that*

economic activity has been rising at a moderate rate. Job gains have been solid” while “business fixed investment and exports remain weak.”

Other than the comments on inflation during his post-FOMC press conference, Chair Powell also noted that some of the uncertainties around trade have diminished recently and signs global growth has stabilized although other concerns have arisen including the coronavirus outbreak in China. He believed that the coronavirus outbreak is likely to cause disruption in China and globally, but it is still uncertain what macroeconomic effects will be at this point. And on the money markets developments, the Fed plans to adjust size of repo operations over the first half of this year. He repeated the Fed expects to continue offering repo support through April and will adjust money market plans as conditions warrant and that the Fed will know when adjustments have run course when reserves are durably at a sustainable level. He viewed that reserve levels will have to be at a level high enough to remain ample; and that US\$1.5 trillion will be bottom end of the sustainable level range.

On wage growth, he found it to be a "bit surprising" that wages have not risen more given such low unemployment. And on trade policy developments, Powell still expresses doubt as the uncertainty over trade has yet to go away for businesses so far and there is a bit of a "wait and see" attitude in his view. Powell does not yet see a decisive recovery for manufacturing.

Our FOMC Outlook – Still Expecting Another Cut In 1Q

The FOMC decision was not a surprise and even though Powell expressed his disdain for the persistently low inflation, the markets only edge expectations up slightly for another Fed rate cut in 2020. Based on trading in futures and options data compiled by Bloomberg (WIRP) (as of 30 Jan), market’s rate cut expectations in March remains relatively low but it did edge up to 10.6% (from 6.2% on 28 Jan) while rate cut expectation further out to the December 2020 FOMC was also slightly higher to 33.3% (from 29% on 28 Jan).

In contrast to the market view of a more prolonged Fed pause, **we still expect the Fed to implement the next 25bps rate cut in 1Q 2020 at the March FOMC**, bringing the upper bound of the FFTR lower to 1.5% and well below the 2% Fed inflation target. We had previously highlighted international trade developments and the geopolitical developments between US and Iran, as factors that may encourage the Fed to lower rates further if these factors threaten US economic outlook. Even if the US-China trade & US-Iran geopolitical tensions have de-escalated, the Fed may still have to take another look at more “insurance” easing, especially if the novel coronavirus outbreak in China worsens and leads to material downside impact on the US and global growth. Furthermore, Powell’s explicit dissatisfaction with US inflation persistently below 2% will add to the downward bias for the FFTR in 1Q 2020.

Conversely, if the abovementioned risk factors ebbs and US inflation starts to materially increase, then the “insurance” cut will be unnecessary. The view remains for the Fed Reserve to keep policy rates low or even lower in 2020.

The next FOMC policy meeting will be on 17/18 March 2020 (decision on 19 Mar, 2am SGT) and will be accompanied by both a Powell press conference and an updated Summary of Economic Projections. But the immediate attention will be stay on China’s Wuhan coronavirus headlines while the key US data will be today’s advance estimate for US 4Q 2019 GDP (30 Jan, 9:30pm SGT) followed by January US Labor market report from the Bureau of Labor Statistics (BLS) next Friday (7 Feb, 9:30pm SGT).

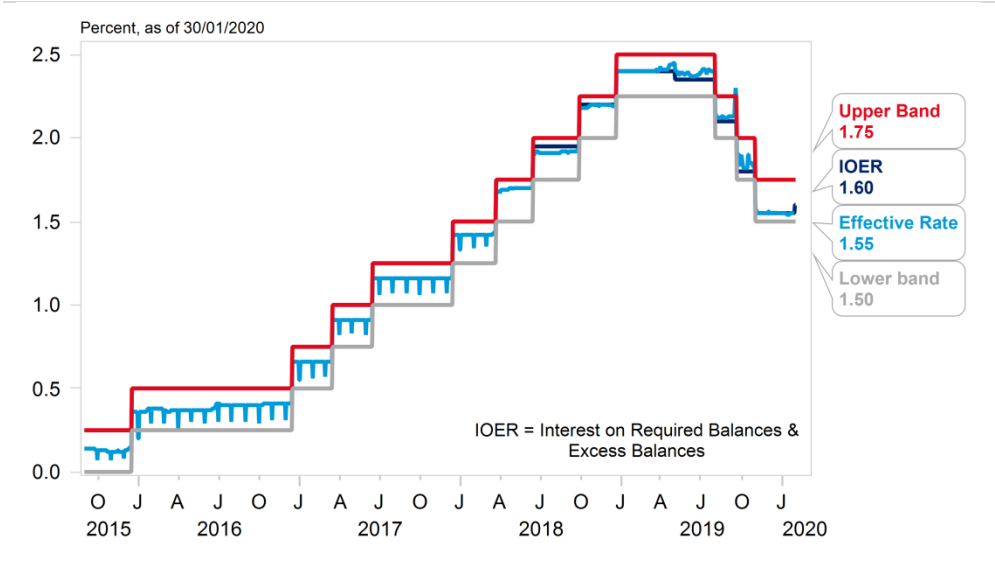
Please click on the links to access the 28/29 January 2020 FOMC statement, the accompanying implementation note and the FOMC calendar for [2020](#).

%	30 Jan	1Q20F	2Q20F	3Q20F	4Q20F
US Fed Funds Target	1.50-1.75	1.25-1.50	1.25-1.50	1.25-1.50	1.25-1.50

Source: UOB Global Economics & Markets Research forecasts (as of 30 Jan 2020).

US Fed Fund Rate And IOER: Keeping IOER Within Fed Funds Range

Source: Macrobond, UOB Global Economics & Markets Research



Disclaimer

This publication is strictly for informational purposes only and shall not be transmitted, disclosed, copied or relied upon by any person for whatever purpose, and is also not intended for distribution to, or use by, any person in any country where such distribution or use would be contrary to its laws or regulations. This publication is not an offer, recommendation, solicitation or advice to buy or sell any investment product/securities/instruments. Nothing in this publication constitutes accounting, legal, regulatory, tax, financial or other advice. Please consult your own professional advisors about the suitability of any investment product/securities/ instruments for your investment objectives, financial situation and particular needs.

The information contained in this publication is based on certain assumptions and analysis of publicly available information and reflects prevailing conditions as of the date of the publication. Any opinions, projections and other forward-looking statements regarding future events or performance of, including but not limited to, countries, markets or companies are not necessarily indicative of, and may differ from actual events or results. The views expressed within this publication are solely those of the author's and are independent of the actual trading positions of United Overseas Bank Limited, its subsidiaries, affiliates, directors, officers and employees ("UOB Group"). Views expressed reflect the author's judgment as at the date of this publication and are subject to change.

UOB Group may have positions or other interests in, and may effect transactions in the securities/instruments mentioned in the publication. UOB Group may have also issued other reports, publications or documents expressing views which are different from those stated in this publication. Although every reasonable care has been taken to ensure the accuracy, completeness and objectivity of the information contained in this publication, UOB Group makes no representation or warranty, whether express or implied, as to its accuracy, completeness and objectivity and accept no responsibility or liability relating to any losses or damages howsoever suffered by any person arising from any reliance on the views expressed or information in this publication.