Economic Research View

U.S.: Review on July FOMC

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The July FOMC has decided a 25bp-hike as widely expected. Fed Chair Jerome Powell explained that, as the reason for this decision, the US economy and inflation have been broadly in line with the FOMC participants' outlook, which suggested that they continued to have one additional hike in their mind. While inflationary pressures have been recently easing in goods prices and rents, Powell said that softening labor market conditions and wage pressures would be necessary for deceleration of services inflation, implying that disinflation without those softening factors will not make the Fed convinced that inflationary pressures are being contained.

The FOMC decided a 25bp-hike as expected. No clear information for future decisions

- The July FOMC has decided a rate hike of 25bp as widely expected. Regarding the reason for this decision, Powell said "the intermeeting data came in broadly in line with expectations". Since the outlook shown at the June FOMC had expected two additional hikes, "data broadly in line with expectations" has warranted a hike at this meeting.
- And the Chair's comment also indicated another hike ahead, but he gave no clear information about its timing. He said "we haven't made a decision to go to every other meeting … it is certainly possible that we would raise rates at the September meeting if the data warrants … (on the other hand) we shouldn't assume that every other meeting is the lowest tightening frequency". Simply said, future decisions will depend on incoming data.

Reasons for disinflation seem to be important to assess inflationary pressures

- There were many questions related to disinflation as the June CPI report had been weaker than expected. A reporter asked if the recent disinflation driven by goods and rents would be enough to hold rates, or economic growth below the trend and decelerating labor growth would be necessary when the Fed assesses inflationary pressures. Chair Powell's reply for this question was not that clear: he only said "it's hard to pick the pieces … we will be looking at everything".
- However, it seemed that Powell will focus on reasons for disinflation, taking care of labor market and services inflation. As for reasons for the recent disinflation, he explained that both normalization of supply conditions and the Fed's monetary policy had been behind the dynamics, and he added (since the benefits from the former have been reaped) "…going forward, monetary policy will be important particularly in the non-housing services sector…" and that wages and "…labor market conditions broadly are going to be an important part of getting inflation back down and that's why we think we need some further softening in labor market conditions". His comments suggested that reasons for disinflation will be important in assessing the sustainability of disinflation, and disinflation without weakening of wage pressures and the labor market will not make the Fed convinced that inflationary pressures are being contained.
- Related to this explanation, Chair Powell seemed to be skeptical about the so-called "no landing" or "soft landing". While he admitted that the resilience of the economy is a good thing, he said "at the

margin, stronger growth could, over time, lead to higher inflation and that would require an appropriate response for monetary policy”.

The terminal level of future rate cuts will be neutral rate, and continuing QT will be consistent with cuts

- Chair Powell mentioned three points related to rate cuts. First, as a reason for rate cuts, he explained “if we see inflation coming down credibly and sustainably, we don’t need to be at a restrictive level anymore”. This clearly means that, as a result of inflation going back to the target, the monetary tightening measured by the FF rate and inflation will tighten more, which will warrant rate cuts to maintain or reduce the degree of the tightening (that said, reasons for disinflation will be important).
- Second, as for the terminal level of rate cuts, Powell said “we can move back to a neutral level and then below a neutral level at a certain point”, which is consistent with the explanation above. Note that, while I was focusing on Powell’s comments on the upside risk of a neutral rate, he said nothing about that.
- And third, regarding the QT in a cycle of rate cuts, he said that continuing QT will be consistent with rate cuts because both rate cuts and QT are a process of normalization of monetary policy. That is, rate cuts will be conducted to make restrictive monetary policy neutral, while QT will be continued to make accommodative effects of the balance sheet neutral (less accommodative).

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.