FOMC meeting, March 19–20

April 10, 2024

Author: **Gregory Daco**

Meeting minutes

Play-by-play on a knife's edge

The minutes of the March Federal Open Market Committee (FOMC) meeting revealed that "all participants" favored holding the fed funds rate constant at 5.25%–5.50%, and "almost all" policymakers judged it would be optimal to ease monetary policy this year if the economy evolved as expected.

While policymakers noted that risks to achieving their dual mandate were becoming better balanced, they stressed the importance of weighing the risk of maintaining a restrictive policy stance for too long, which could unduly weaken the economy, against the risk of easing policy too quickly, which could stall or even reverse disinflation progress.

Policymakers noted in their discussion that they were still seeking greater confidence that inflation was moving sustainably toward 2%. As such, the recent strong economic data and "disappointing" inflation readings in January and February were viewed as evidence that easing monetary policy wasn't yet the optimal decision.

Fed policymakers emphasized the importance of policy optionality and carefully assessing incoming data to judge whether inflation is moving down sustainably to 2%.

In particular, the minutes noted elevated uncertainty regarding the inflation outlook. Policymakers stressed that upside risks to inflation stemmed from geopolitical risks, higher commodities prices and easing financial conditions that could support stronger growth and inflation. However, they also noted optimism regarding the better-balanced labor market supporting lower core non-housing inflation, slower shelter cost inflation, increases in the labor force and stronger productivity growth, as well as business contacts indicating that they were less able to pass on price increases or that consumers were becoming more sensitive to price changes.

As Fed Chair Jerome Powell noted during the post-FOMC meeting press conference, policymakers noted that while the balance sheet runoff was proceeding smoothly, it would be prudent to begin slowing the pace of runoff "fairly soon." This would reduce the risk of repeating money market stress (as in 2019). Policymakers favored reducing the monthly pace of runoff by half, by maintaining the existing cap on agency mortgage-backed securities while adjusting the redemption cap on Treasury securities. Policymakers favored moving to a balance sheet that consists primarily of Treasury securities in the long run.

The Fed won't publish a new dot plot of policy rate expectations until mid-June, but if policymakers were surveyed today (after the March Consumer Price Index (CPI) report), we believe the median dot plot would show 50 basis points (bps) of rate cuts in 2024 with the fed funds rate at 4.88% in Q4 2024 — with 10 or more policymakers favoring two or fewer rate cuts this year. This aligns with current market pricing showing the odds of a June rate cut at 16% (down from 53% before the CPI report) and less than two full rate cuts priced in 2024.

We believe market pricing is extreme with the odds of a September onset of the easing cycle at just 44% given that underlying disinflationary dynamics remain firmly in place. Specifically, cooler consumer demand growth, declining rent inflation, narrower profit margins, moderating wage growth and stronger productivity growth should prevent disinflation from stalling.

As such, the key reason why a June onset to the easing cycle looks less probable is not that disinflation has stalled, but rather that the Fed won't have the lead time to signal greater confidence in inflation moving toward the 2% in the May statement. Indeed, we believe Powell would have favored shifting the key sentence in the FOMC statement into a positive one in May, signaling the onset of the easing cycle in June: "The Committee expects it will be appropriate to reduce the target range once it has gained greater confidence that inflation is moving sustainably toward 2 percent."

Until we see the Producer Price Index (PPI) and personal consumption expenditures inflation data, we'll maintain our view that the first rate cut will come in June and that the Fed will proceed with three rate cuts this year. However, we acknowledge the growing risk that the easing cycle may be delayed to later this summer with the Fed only proceeding with two rate cuts — not because it would be optimal, but because several policymakers have become myopically data-dependent.

Meeting recap

Powell downplays data noise but refrains from a clear policy signal

The FOMC voted unanimously to hold the federal funds rate at 5.25%–5.50%. The statement was largely unchanged, the dot plot continued to show three rate cuts in 2024 — the same as in the December dot plot — and GDP growth projections were revised up without a commensurate upgrade to inflation and employment, signaling a belief in non-inflationary growth supported by stronger productivity.

We continue to expect the onset of the Fed easing cycle in June, and we believe the Fed is more likely to proceed with three rate cuts in 2024, rather than the four we had previously anticipated.

- **Optionality in the statement:** There were almost no changes to the FOMC statement, and the sentence noting "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" was preserved.
  We believe that sentence may be turned into a positive statement in May, signaling the onset of the easing cycle in June while preserving policy optionality: "The Committee expects it will be appropriate to reduce the target range once it has gained greater confidence that inflation is moving sustainably toward 2 percent."
- **Vote tally:** There were no dissents to the FOMC policy decision as no Fed policymaker has expressed significant conviction in the need to immediately alter the monetary policy stance. While there is a broad consensus that the policy rate is likely at its peak and officials view risks to the outlook as being more balanced, there is still a lingering fear that inflation could reignite.

- **Dot plot points to three cuts per year:** The median dot plot continues to indicate 75 bps of rate cuts in 2024 with the fed funds rate at 4.63% in Q4 2024. The tally shows nine policymakers favoring three cuts and one official favoring four cuts this year while nine favor two or fewer cuts. The Q4 2025 median projection was revised up by 25bps to 3.9% indicating 75bps of rate cuts next year. The estimate of the long-term neutral rate was revised up marginally (10bps) to 2.6%, but Powell noted the precise estimate matters less than the fact that rates will likely stabilize higher than in the decade pre-pandemic.
- **Summary of Economic Projections (SEP):** The new SEP illustrates Fed officials' belief that non-inflationary growth can be sustained via stronger labor supply and productivity growth:
  - The 2024 GDP growth outlook was revised up significantly to 2.1% year over year (y/y) in Q4 (vs. 1.4% previously). GDP growth was also nudged higher to 2% in both 2025 and 2026 from 1.8% and 1.9%, respectively. The unemployment rate is now expected to rise mildly toward 4.0% in Q4 2024, compared with 4.1% previously.
  - Fed officials acknowledged that the last disinflation mile could prove a little "bumpier" than anticipated, but they continue to anticipate disinflation. Core inflation projections were revised up slightly: core personal consumption expenditures inflation is expected at 2.6% y/y in Q4 2024 (vs. 2.4% previously), while the 2025 projection remained unchanged at 2.2% y/y.
  - While most policymakers saw the risks to the core inflation outlook as broadly balanced in December, a majority now views risks as tilted to the upside.
- **Discussion balance sheet normalization:** Powell noted ongoing discussions regarding the likely timing of quantitative tightening (QT) tapering. He stressed that while the FOMC hadn't made any decision, "it will be appropriate to slow the pace of runoff fairly soon." He added that the aim was to avoid the mistakes of the past when there was liquidity stress (like in 2019). The Fed will be carefully slowing the QT process to ensure a smooth transition to an "ample" level of reserves. Decisions on the ideal composition and maturity of the balance sheet will be made later, but the Fed favors a balance sheet that is mostly composed of Treasuries.
- **Neutral press conference:** Powell reiterated the now-familiar message that the policy rate is likely at its peak and that it would likely be appropriate to start easing policy "at some point this year."

  He acknowledged the notable easing of inflation over the past year and noted that the stronger-than-expected inflation readings in January and February were more noise than signal. In particular, he said "January/February inflation data haven't changed the overall story of inflation moving down gradually on a sometimes-bumpy road toward 2%." This acknowledgment of inflation bumpiness is a significant pushback against the misleading narrative of entrenched inflation and inflation resurgence on reaccelerating economic activity — neither of which is true.

  Powell said that while the higher January and February inflation readings certainly haven't raised anyone's confidence that inflation is moving sustainably toward 2%, "the story is essentially the same: inflation coming down gradually toward 2% on a sometimes-bumpy path."

  Powell further added that "strong job growth is not a reason for us to be concerned about inflation," acknowledging the labor supply rebound and implicitly suggesting stronger productivity growth is part of the picture. He noted, "You saw that last year, strong hiring and inflation coming down quickly."

  On the recent easing of financial conditions, Powell noted that the committee believes financial conditions are weighing on economic activity, and that is the most important factor.

  He highlighted the two-sided risks of easing monetary policy too soon or too late, but maintained a relatively neutral tone instead of focusing on the fact that reducing policy restraint too soon or too much could result in a reversal of the progress seen in inflation.

  When asked whether unanimity would be required for the onset of the easing cycle, he stressed that the Fed was a "consensus-oriented organization, but people do dissent … Life goes on …"

How EY-Parthenon can help

Strategy consulting services

Read more

Contacts

Gregory Daco

EY-Parthenon Chief Economist
Strategy and Transactions
Ernst & Young LLP

Lydia Boussour

EY-Parthenon Senior Economist
Strategy and Transactions
Ernst & Young LLP

Marko Jevtic

EY-Parthenon Senior Economist
Strategy and Transactions
Ernst & Young LLP

See more on Macroeconomic insights

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

About EY-Parthenon
EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their ecosystems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized — helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

© 2024 Ernst & Young LLP.
All Rights Reserved.

CS no. 2407-4565112

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

ey.com

The views reflected in this article are the views of the author(s) and do not necessarily reflect the views of Ernst & Young LLP or other members of the global EY organization.