**Central Banks**

# FOMC Meeting: January 28th-29th

Nathaniel Karp / Boyd Nash-Stacey
**January 29, 2020**

Considering the absence of material changes over the intermeeting period, the Fed left target range of federal funds rate unchanged at 1.5-1.75%. However, in an effort to "…foster trading in the federal funds market at rates well within the FOMC's target range", the Fed made a "technical" adjustment and increased the interest paid on excess reserves (IOER) by 5bp to 1.6%, which is 10bp above the lower end of the range.

In terms of the statement, there were two changes. First, a slight downgrade to the outlook on household spending from "strong" to "moderate". Second, the statement altered the committee's expectation for inflation from "near" the committee's symmetric target to "returning to". While the change, prior to the press conference, appeared to signal a slight upward adjustment in the committee's view on inflation, in actuality, the Chair noted in his press conference that this adjustment related to concerns that keeping "near" in the statement could lead market participants to infer that the committee was OK with inflation below target.

With few changes to the statement and no material adjustment in the committee's outlook on the balance of risks, the comments at the press conference on the stance of accommodation were boilerplate (in some cases prepared). While the Chairman addressed the risk of the coronavirus 2019-nCoV he did not provide evidence that the committee had a strong position on the impact it could have on the U.S. economy, saying only that it is in its early stages and that they are "closely monitoring" the situation. Outside the pandemic risks, the Chairman noted that there were "grounds for cautious optimism" for the global economy, marking a major swing from 2019.

On the balance sheet strategy and its implications, the Q&A provided some clarity on what the terminal level of reserves could be and if there were any concerns about the nontrivial increase in the size of the balance sheet. On the issue of equilibrium levels, the Chairman only conceded that the committee expects the floor for the level of reserves will be close to that observed in September ($1.5Tr), and that seasonal deviations and possible upward drift away from that "bottom end" were highly likely. When asked about the impact that repo and Treasury bill purchases were having on financial markets, he demurred that the purchases were affecting markets.

In addition to the balance sheet issues, the committee's review of its inflation strategy came up multiple times. The Chairman implied that there should be some conclusions ready to be shared with the public by mid-year. He also stressed that it would not have a major impact on the "current" stance of policy, but "over time" these changes could alter monetary policy decisions. Nonetheless, it is not clear how an updated inflation strategy will better equip the Fed to deal with a flatter Phillips curve and low neutral interest rates, particularly if these are driven by secular changes such as global disinflation, technology, productivity, demographics, savings glut, etc.

A question on climate change risks and its impact on financial stability in the U.S. caught the Chairman flat-footed. Implicit in his answer was the fact that this issue was not a top priority for the Fed. In fact, he deferred to other agencies, "society" and elected officials to address this issue at odds with peers in other developed countries. In fact, when asked about the Fed's reluctance to sign on to the Network for Greening the Financial System, the Chairman said that they have attended meetings, but have not made a decision on membership.

## Bottom Line

We continue to believe that the Fed will remain on hold throughout 2020 given the more upbeat outlook, lower uncertainty and diminished global risks, amid muted inflationary pressures. While the Chairman downplayed the risks to the U.S. economy from the Wuhan coronavirus, the growing number of 2019-nCoV cases and increased efforts to quarantine effected areas suggests economic spillovers to the rest of the world could be significant, presenting what could be characterized as a material change to their outlook.

With respect to the balance sheet, today's meeting seems to suggest that there have been no changes in the committee's view of the benefits or risks of the current policy and that ongoing Treasury bills purchases and a slow and gradual move away from the repo market is the most likely scenario. While the guidance on the eventual size of the balance sheet was unchanged, we expect reserves to remain significantly above it. Today's "technical" adjustment to IOER, however, suggests that the current balance sheet strategy could still present operational risks that may need to be addressed throughout the year. Notwithstanding major surprises it appears 2020 provides the perfect opportunity for the Fed to present its updated policy framework and its implications.