AEGON Asset Management

FOMC UPDATE: A BIT OF A SNOOZER

By Calvin Norris, CFA, Portfolio Manager and US Rates Strategist

The FOMC just concluded its two-day meeting and, as expected, left the federal funds rate target unchanged. It did, however, lower the interest rate on excess reserves (IOER) by 5 basis points for technical reasons, but this was also expected.

In regards to its published statement (Exhibit 1), the market was expecting the Fed to remain "on hold," and again, the FOMC did not disappoint in that regard. The market (myself included) was also expecting relatively subdued comments from the FOMC pertaining to the recent slowdown in economic growth and inflation. The committee's only mention of these was adding "slowed" to the comment, "Growth of household spending and business fixed investment slowed in the first quarter," adding, "…inflation…has declined and [is] running below 2 percent."

Although these comments were relatively understated, the market appeared to be caught a bit short (possibly due to month-end duration extensions and relatively weak ISM numbers today), prompting a modest rally in Treasuries.

At this point, we are discounting this rally, acknowledging that now that Treasury yields have fallen below 2.50% on the 10-year, the next significant technical objective is 2.40%. That said, a pullback back towards 2.50%, or slightly higher, seems plausible.

Exhibit 1: Side-by-side comparison of 2019 FOMC statements

May 1, 2019

Information received since the Federal Open Market Committee met in March indicates that the labor market remains strong and that economic activity rose at a solid rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Growth of household spending and business fixed investment slowed in the first quarter. On a 12-month basis, overall inflation and inflation for items other than food and energy have declined and are running below 2 percent. On balance, market-based measures of inflation compensation have remained low in recent months, and survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. In support of these goals, the Committee decided to maintain the target range for the federal funds rate at 2-1/4 to 2-1/2 percent. The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Voting for the FOMC monetary policy action were: Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; Richard H. Clarida; Charles L. Evans; Esther L. George; Randal K. Quarles; and Eric S. Rosengren.

March 20, 2019

Information received since the Federal Open Market Committee met in January indicates that the labor market remains strong but that growth of economic activity has slowed from its solid rate in the fourth quarter. Payroll employment was little changed in February, but job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Recent indicators point to slower growth of household spending and business fixed investment in the first quarter. On a 12-month basis, overall inflation has declined, largely as a result of lower energy prices; inflation for items other than food and energy remains near 2 percent. On balance, market-based measures of inflation compensation have remained low in recent months, and survey-based measures of longer-term inflation expectations are little changed.

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Source: The Fed. As of May 1, 2019.

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