

## US Daily: May FOMC Recap: A Pause Is the Baseline (Mericle)

- We saw the May FOMC meeting as supportive of our call for a pause in June. The FOMC removed from its statement the earlier guidance that some additional policy firming may be appropriate, and while the nod toward a June pause was not quite as strong as we had expected, Chair Powell emphasized twice that this is a “meaningful change.”
- The FOMC also made it clear that it now sees the credit tightening as a fact rather than just a likely possibility, which adds to the case for a pause. Powell noted that credit had already been tightening for a while before the banking turmoil began and hinted that the next release of the Senior Loan Officer Opinion Survey will reflect the further tightening implied by the Beige Book.
- Powell said that he does not expect a recession, unlike the Fed staff, and he made his clearest statement so far that he thinks a soft landing is possible and finds the labor market rebalancing to date encouraging, views that we share. We see this as dovish too—if Powell thinks that a recession is not necessary to solve the inflation problem, he will be reluctant to deliver future hikes that he thinks would materially raise the risk of pushing the economy into a recession.

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## May FOMC Recap: A Pause Is the Baseline

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We saw the May FOMC meeting as supportive of our call for a pause at the next meeting in June. Most importantly, the FOMC removed from its post-meeting statement the earlier guidance that some additional policy firming may be appropriate, and Chair Powell emphasized twice that this was a “meaningful change” during his press conference.

The Committee replaced that language with guidance that “the extent to which additional policy firming may be appropriate” will depend on the considerations it has set out in the past, similar to the language we expected it to use to indicate that it retains a hawkish bias.

Admittedly, the statement did not nod toward a June pause quite as strongly as we had expected. Specifically, it did not say that the current policy stance will most likely be sufficiently restrictive to return inflation to target, as we had anticipated. But putting together a statement that was acceptable to everyone when the range of views on the appropriate path forward is wide was likely difficult, and in retrospect we are not surprised that the FOMC simply chose to say less.

The FOMC also made it clear that it now sees the credit tightening as a fact rather than just a likely possibility, which adds to the case for a pause. Powell noted that credit conditions had already been tightening for a while before the recent banking turmoil began and tightened further once the recent strains emerged in the banking sector in March. He also hinted that the next release of the Senior Loan Officer Opinion Survey will reflect the further tightening implied by the Beige Book.

Powell said that the credit tightening would weigh on economic activity and that its impact remains uncertain. Asked what the FOMC needs to see to conclude that its policy stance is sufficiently restrictive, he noted that the combination of real interest rates that are meaningfully above most estimates of neutral, the Fed’s balance sheet reduction, and the credit tightening add up to enough that “we may not be far off, or possibly even [are] at that level.”

On a separate note, Powell said that he does not share the Fed staff’s forecast of a mild recession. He also made his clearest statement so far that he thinks a soft landing is possible and that he finds the labor market rebalancing to date encouraging, views that we share.

Specifically, Powell noted that supply and demand in the labor market are coming back into better balance, that surveys and other evidence point to gradual labor market cooling, that job openings have fallen sharply without unemployment rising, and that wage growth has been slowing down to a more sustainable rate. All of this, he said, makes it possible that “we can continue to have a cooling in the labor market without having the big increases in unemployment” seen in prior cycles.

We see Powell’s view on the soft landing question as having dovish implications—because he thinks that a recession is not necessary to solve the inflation problem, he is

likely to be reluctant to deliver future rate hikes if he thinks that they would materially raise the risk of pushing the economy into a recession.

**David Mericle**

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