

FED COMMENTS UPBEAT ON GROWTH



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This is Christian Brobst. I'm here with Chuck Carmody, Vice President and Co-Portfolio Manager for Fixed Income Strategies. We're here to discuss the Fed statement release this afternoon and the subsequent press conference with Chair Powell. Chuck, we'll get right into it.

Q: *It seems that the Fed statement today took an intentional turn to be more focused on the recent inflation trends. Was that a predictable pivot?*

A: I would say, yes. It was exactly as we expected. We expected the Fed to downgrade their language on inflation and to upgrade their language on growth. A lot of that coincides with the recent data. As we've seen, Q1 GDP data came in at 3.2% for the U.S. We've also seen improvements in both China and Europe. Along the same lines, some of the inflation indicators recently have been weaker than the Fed would like and with that we expected these changes in the Fed statement.

Q: *So we've seen some inconsistencies in the past with Chair Powell between what the Fed releases in the statement and his press conference commentary. Did you notice anything that stood out today?*

A: As a matter of fact, I did. As we just discussed, the language in the statement was definitely tilted more towards inflation. What we saw as he started to talk in the press conference was that he focused more on growth and was much more upbeat on growth. I think, along those same lines, what we noticed was that the market reaction was fairly significant along with his comments. We saw, especially in the front of the curve, rates move materially wider as he started to talk and appeared to be more upbeat on growth and a little bit less concerned about inflation.

Q: *There's been a good deal of financial press attention on something called the interest on excess reserves or IOER in recent weeks. It's a rate that, I feel, historically gets less focus than the federal funds rate. Can you explain the difference for us?*

A: First off, there definitely has been more chatter in the markets recently on IOER. I think it helps to start with the definition. Quite simply, the IOER is the interest rate the Fed pays to banks who deposit excess reserves at the Fed. Historically, the IOER has been slightly below the fed funds rate. What we've seen in recent days is that the IOER has

been about 5 basis points higher than the fed funds rate. The commentary coming into this meeting largely was around the idea that the Fed may consider cutting the IOER but that it was probably too soon. Well, in fact, they did decide to cut it 5 basis points at this meeting. I think the important point to emphasize here is that this is largely a technical adjustment. This is not a policy shift.

Q: *What about any new balance sheet related details? I know Chair Powell mentioned that there had been some preliminary discussion about the maturity composition.*

A: He talked about this a little bit in the press conference this afternoon. He didn't give a lot of detail around balance sheet composition, he just indicated that they had begun discussions on and that they would continue to discuss this matter going forward at future meetings.

One popular theory that's out in the marketplace right now is that the Fed will start to tilt their holdings toward the front end of the curve, such that the next time they need to react or there's a recession, they're able to implement

another Operation Twist. So, there are many market participants that think this is a likely outcome here. We'll see, but clearly the Fed is discussing this, and we should expect more information in the future.

Q: *This afternoon's vote was unanimous, but I know there's a strong hawk on the voting rotation this year with Esther George and also a strong dove with James Bullard. Would you expect that there'd be any likelihood of dissension in upcoming meetings?*

A: I think it's likely you start to see a little bit more dissent in upcoming meetings. One thing the Fed has been very clear about recently is that they're more data dependent now. So, as the economic outlook evolves, as there's more debate within the Fed, I expect there to be a little bit of dissent. That said, the Fed is usually pretty good about getting most of the committee on the same page, but we'll see.

All right, Chuck. Thanks for taking the time to walk through the Fed's actions this week. We'll look forward to checking in again with an update on the June 18-19 FOMC meeting.

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