Daiwa Capital Markets

U.S. FOMC Review

- FOMC: highly supportive

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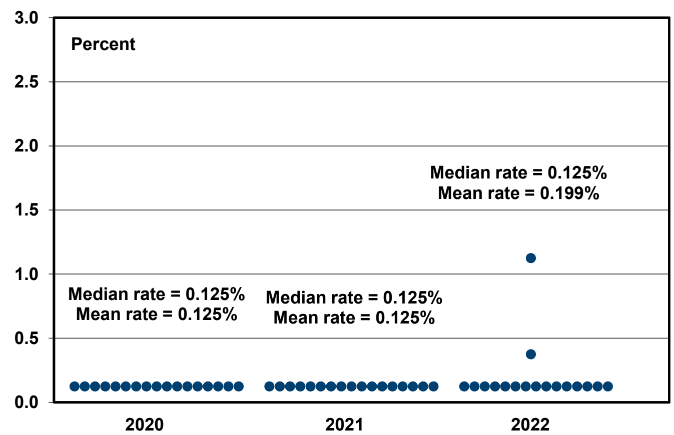
U.S. Monetary Policy

As widely expected, the Federal Open Market Committee did not make any fundamental changes in policy, and the Board of Governors did not offer any new credit facilities (or adjustments to existing facilities). Nevertheless, we viewed the information conveyed by the Committee as eventful, as it showed officials intend to run a highly accommodative policy for an extended period.

The FOMC did not alter the forward guidance in its policy statement. Again, the statement merely noted that the current target range for the federal funds rate would be maintained until officials were confident that the economy is on track to achieve the Committee's employment and price stability goals.

FOMC Rate View: Year-End 2020, 2021, & 2022*



* Each dot represents the expected federal funds rate of a Fed official at the ends of 2020, 2021, and 2022. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the June 2020 meeting.
Source: Federal Open Market Committee, Summary of Economic Projections, June 2020

However, the Summary of Economic Projections allows one to draw inferences about the likely path of policy, and those projections suggested a high degree of accommodation from the Fed. Specifically, the Fed effectively has policy on hold through 2022 despite good progress in reducing unemployment (5.5 percent in the fourth quarter of 2022; see chart and table). Only two officials anticipate higher interest rates at the end of 2022 (one of those officials has a shift of only 25 basis points). The range of forecasts shows an unemployment rate of 4.0 percent at the lower bound, suggesting that officials would need to see a jobless rate convincingly below five percent before they contemplate higher interest rates. Contained inflation (below the 2.0 percent target throughout the forecast horizon) no doubt contributes to the friendly stance as well.

The dovish leaning of the Committee also was evident in the press briefing. A reporter asked how might the Fed respond if the economy recovered quickly and was stronger than expected. Powell indicated that the Committee was not considering higher interest rates. Mr. Powell also noted several times during his briefing that the previous expansion demonstrated that unemployment can go quite low without stirring inflation. Thus, no need to be contemplating higher interest rates.

We were hoping for guidance on quantitative easing, but the statement and Chair Powell offered little, merely noting that security purchases would be maintained at least at the current pace over coming months. Market participants were expecting information on the possibility of the Fed adopting so-called yield curve control (pegging Treasury interest rates). Chair Powell noted that the Committee discussed the issue but did not draw conclusions. Comments in the press briefing implied that the probability of adopting this approach in the near-term was limited, as Mr. Powell indicated that current monetary policy was well positioned to support the economy.

The Fed is not contemplating policy normalization at this time, but it is expecting recovery. The Summary of Economic Projections shows a drop in real GDP of 6.5 percent this year. Assuming the economy fell at an annual rate of 20 percent in the first half of the year (off 5.0 percent in Q1 and down 35 percent in Q2), this view implies an annual rate of growth of 7.0 percent in the second half. The economy is then seen growing 5.0 percent next year and 3.5 percent in 2022.

This path, while seemingly respectable, leaves the Fed short of its policy goals. Projected inflation is below the target of 2.0 percent through 2022 and the unemployment rate is close to two percentage points above its pre-virus level. The most optimistic forecast has the unemployment rate at 4.0 percent in the fourth quarter of 2022. Chair Powell in his press briefing suggested that the unemployment rate might be able to move below 3.5 percent without stirring inflation or generating imbalances.

Economic Projections of the FOMC, June 2020*

	2020	2021	2022	Longer Run
Change in Real GDP	-6.5	5.0	3.5	1.8
Range of Forecasts	-10.0 to -4.2	-1.0 to 7.0	2.0 to 6.0	1.6 to 2.2
Unemp. Rate	9.3	6.5	5.5	4.1
Range of Forecasts	7.0 to 14.0	4.5 to 12.0	4.0 to 8.0	3.5 to 4.7
PCE Inflation	0.8	1.6	1.7	2.0
Range of Forecasts	0.5 to 1.2	1.1 to 2.0	1.4 to 2.2	2.0
Core PCE Inflation	1.0	1.5	1.7	--
Range of Forecasts	0.7 to 1.3	1.2 to 2.0	1.2 to 2.2	--
Federal Funds Rate	0.1	0.1	0.1	2.5
Range of Forecasts	0.1	0.1	0.1 to 1.1	2.0 to 3.0

* *Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, June 2020