Daiwa Capital Markets

U.S. FOMC Review

- FOMC: a few interesting developments

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The September FOMC Meeting

As widely expected, the Federal Open Market Committee did not make any fundamental adjustments to policy, but it made a few noteworthy tweaks.

Chair Jerome Powell emphasized in his prepared remarks and in his Q&A session the change in the Committee's forward guidance. Officials had been offering only vague guidance at the past few meetings (policy would remain accommodative until the economy had weathered recent events). Now, the Committee is indicating that it will maintain an accommodative stance until inflation is **moderately** above two percent and is on track to average two percent **over time**.

Chair Powell described the guidance as powerful, although it still contains a good bit of wiggle room. For example, the statement does not offer any clues on the definition of "moderate" and it offers no insight into the time period over which inflation should average two percent. Chair Powell ducked these issues in the Q&A session. Also, the statement indicates that policy would remain accommodative until goals are met, but accommodative does not necessarily mean the current stance. The Fed could raise interest rates to a degree and still remain in an accommodative stance.

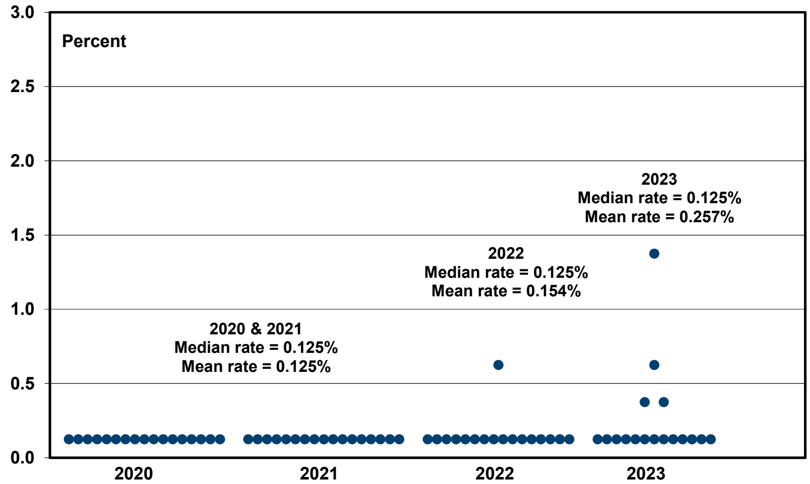
Although the Fed could raise interest rates and still remain accommodative, it is not expecting to do so in the next few years. The new not plot shows that no official foresees higher interest rates this year or next. Only one policymaker expects to increase rates in 2022 (down from two officials in June). The median dot remains at 0.00-0.25 percent in 2023, although four officials see higher rates that year (chart, next page).

Other elements of the Summary of Economic Projections (SEP) changed noticeably for 2020, with policymakers now more optimistic than they were in June. The expectation for GDP growth is almost three percentage points firmer than previously believed, and the expected unemployment rate is 1.7 percentage points lower than the June view (table, next page). We also were struck by the upbeat tone of Chair Powell's comments during the press briefing. At one point he noted that economic activity in the past 60 days was stronger than he expected. The firmer growth expected this year borrowed to a degree from activity in the next two years, as expected GDP growth in 2021 and 2022 is a bit slower than previously expected.

The statement made a small change in its description of its quantitative easing program, now adding that asset purchases "help to foster accommodative financial conditions". Previously, QE was portrayed as an effort to promote smooth market functioning. The change is notable in that it offers a rationale to keep the program going. With trading activity now essentially normal in the fixed-income markets, the Fed could have ended the effort, but it obviously wants to keep the program going.

Two policymakers dissented from the decisions made at today's meeting, although the reasons for their disagreement were opaque. Robert Kaplan of the Dallas Fed wants "greater policy rate flexibility" after the Fed reaches its goals of maximum employment and average inflation of two percent. We were left wondering "greater than what"? The statement gives no hint of the degree of flexibility that will be pursued. Neel Kashkari of the Minneapolis Fed wants to maintain the current target range until core inflation has reached two percent on a sustained basis. Is his disagreement with core versus headline inflation? Or is he emphasizing stability in the current stance; that is, no policy change, even a slight one that would maintain an accommodative stance, until inflation reaches two percent on a sustained basis.

FOMC Rate View: Year-End 2020, 2021, 2022, & 2023*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2020, 2021, 2022, and 2023. 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 September 2020 meeting.*

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

Economic Projections of the FOMC, September 2020*

	2020	2021	2022	2023	Longer Run
Change in Real GDP	-3.7	4.0	3.0	2.5	1.9
June projection	-6.5	5.0	3.5	--	1.8
Unemployment Rate	7.6	5.5	4.6	4.0	4.1
June projection	9.3	6.5	5.5	--	4.1
PCE Inflation	1.2	1.7	1.8	2.0	2.0
June projection	0.8	1.6	1.7	--	2.0
Core PCE Inflation	1.5	1.7	1.8	2.0	--
June projection	1.0	1.5	1.7	--	--
Federal Funds Rate	0.1	0.1	0.1	0.1	2.5
June projection	0.1	0.1	0.1	--	2.5

** Median projections*

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

September FOMC Statement

The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.

The COVID-19 pandemic is causing tremendous human and economic hardship across the United States and around the world. Economic activity and employment have picked up in recent months but remain well below their levels at the beginning of the year. Weaker demand and significantly lower oil prices are holding down consumer price inflation. Overall financial conditions have improved in recent months, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

The path of the economy will depend significantly on the course of the virus. The ongoing public health crisis will continue to weigh on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace to sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Patrick Harker; Loretta J. Mester; and Randal K. Quarles.

Voting against the action were Robert S. Kaplan, who expects that it will be appropriate to maintain the current target range until the Committee is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals as articulated in its new policy strategy statement, but prefers that the Committee retain greater policy rate flexibility beyond that point; and Neel Kashkari, who prefers that the Committee indicate that it expects to maintain the current target range until core inflation has reached 2 percent on a sustained basis.

Source: Federal Open Market Committee