June 16, 2021

Fed: FOMC *slowly* coming around

By Taylor Schleich/Jocelyn Paquet/Warren Lovely

As fully expected, the FOMC, in a unanimous vote, left the target range for the federal funds rate unchanged at 0% to 0.25% at the conclusion of its two-day meeting. The Fed did, however, nudge the IOER and RRP rate higher by 5 basis points to 0.15% and 0.05%, respectively. Importantly, there were no changes made to the Fed's asset purchases or the guidance for them: "*the [Fed] will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals*."

As for the statement's characterization of the economy/outlook, there were just a few changes made:

- On the virus, the statement now notes that "*Progress on vaccinations has reduced the spread of COVID-19 in the United States*". Moreover, "*Progress on vaccinations will likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remain*."
- The Fed also tweaked its characterization of inflation: It previously noted that inflation *is* running persistently below its longer-run goal. It now notes that it *has run* persistently below its longer-run goal. To us, this as at least an acknowledgement that we're no longer undershooting the 2% target over a longer-term horizon.

Beyond these small tweaks/additions, there were not any changes to the policy statement

A key focus leading up to today's statement was the Fed's updated Summary of Economic Projections (SEP) and dot plot. Once again, the FOMC opted to increase its growth projection for 2021, from 6.5% to 7.0%. 2022's projection was left unchanged at 3.3% while 2023's number was upgraded from 2.2% to 2.4%. Despite weaker-than-anticipated employment reports in the last two months, FOMC members still expected the unemployment rate to drop to 4.5% by the end of the year. At the end of 2022, the SEP showed unemployment at 3.8%, i.e. two ticks below what the Fed considers to be the long-term equilibrium level for that indicator (4.0%). As expected, latest forecasts showed much stronger inflation anticipations than in March. Case in point, the Fed's 2021 PCE deflator forecast was raised a full percentage point, from 2.4% to 3.4%. Policymakers expected inflation to slide back to 2.1% in 2022 (as compared with 2.0% in March's SEP).

Press conference

Perhaps most notably, Chair Powell said that we can consider this meeting the "talking about talking about" meeting, referencing guidance he'd famously given earlier on an eventual taper. Still though, a bit more patience will be required, and the Fed will need to see more data before it is confident that "substantial further progress" has been met. While he noted we are making progress, it evidently isn't "substantial" enough at this time to start signaling a wind down of bond-buying. He noted that it will begin assessing progress towards its goals "meeting-by-meeting". So, it appears that every meeting is now "live" for a potential taper announcement. In any event, Powell still wants to provide "a lot of notice" and reiterated that any eventual taper will be "orderly, methodical and transparent". When it came to discussing the significant moves in the dot plot, Powell was quite dismissive. He conceded that dots are not a great forecaster of future rate moves and should be taken with a "big grain of salt". Rather, in the near-term, the policy tool of focus is asset purchases. On inflation, Powell unsurprisingly reiterated that price pressures are expected to be transitory. However, he conceded that there is a chance that inflation could linger and have an impact on expectations. For now at least, he sees long-term inflation expectations as anchored and "at a good place". Finally, Powell was also pretty upbeat on the employment situation, noting that "we are on a path to a very strong labour market". The Fed expects labour supply to start coming on line later this summer/into the fall and acknowledged that there have also been "a significant number of retirements" (which would imply a smaller jobs deficit and a lower bar for the employment rate, all else equal).

Bottom line

While it wasn't necessarily shocking, a majority of the FOMC is now conceding that rate hikes may be introduced by the end of 2023. This change was far from a guarantee in the lead-up to the meeting. What came as more of a surprise to us was the number of dots that moved. In March, just 7 participants saw a rate hike before the end of 2023. That has now moved to 13. Moreover, 3 more dots moved into 2022 (for a total of 7), meaning we'll just need two more for half of the committee to be in the 2022 rate hike camp. We'd highlight that the median dot for year-end 2023, currently implying two rate hikes, is less aggressive than our current outlook which incorporates at least three hikes. Clearly, the market hadn't been positioned for the less dovish policy rate outlook judging by the reaction seen in the Treasury market just after 2PM.

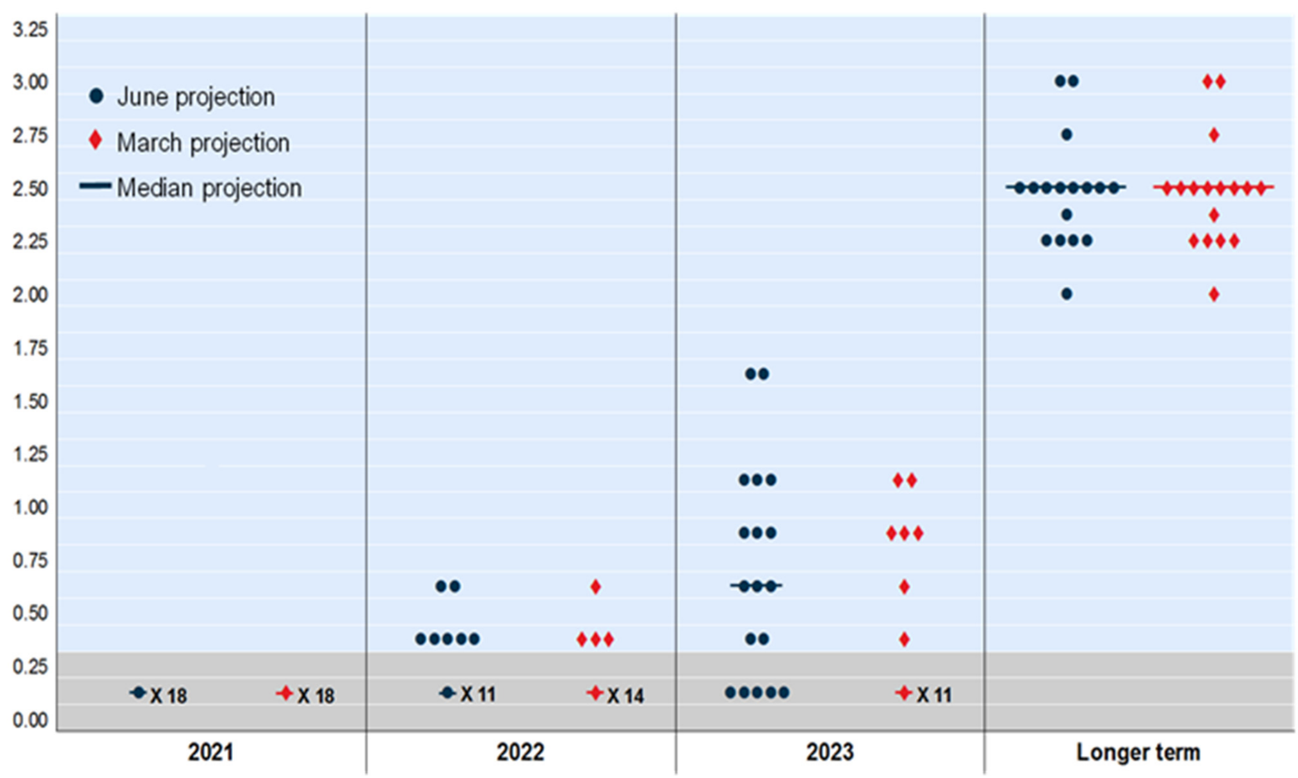
Changes to the GDP growth and unemployment rate forecasts were fairly modest, though Powell's press conference seemed to indicate more optimism on the employment outlook. Meanwhile, PCE inflation projections reflect the Fed's view that increased price pressures are transitory. While 2021 forecasts saw PCE and core PCE estimates revised higher by 1.0%-pts and 0.8%-pts respectively, median 2022 and 2023 projections are just 0.1% above where they were in March. We'd note that we've got a less laissez-faire view of current inflationary pressures than the Fed does. While we won't don't think we'll be talking about 5% CPI readings in perpetuity, we're looking for well-above-target inflation on a more permanent/less transitory basis. Ultimately though, it will take at least a few more months of data to know who's on the right side of this debate. However, should our outlook materialize, we expect continued moves on the dots into 2023 (and potentially more in 2022) by the time the next Summary of Economic Projections drop in September. In any case, rate hikes are still a long way out, even under our higher-inflation outlook. The key focus now is on the Fed's bond-buying and we believe a Fed announcement isn't too far off. August's Jackson Hole Symposium seems like it would be a natural time to make the announcement, but we also wouldn't rule out the July Fed meeting, depending on how strong data comes out over the next month. In either case, we see a taper kicking off in the fourth quarter and likely extending into the fourth quarter of 2022 before the road is paved for a move higher on the policy rate.

FOMC: Summary of Economic Projections

	Latest	March projections
Change in real GDP (%)		
2021	7.0	6.5
2022	3.3	3.3
2023	2.4	2.2
Long run	1.8	1.8
Unemployment Rate (%)		
2021	4.5	4.5
2022	3.8	3.9
2023	3.5	3.5
Long run	4.0	4.0
PCE Inflation (%)		
2021	3.4	2.4
2022	2.1	2.0
2023	2.2	2.1
Long run	2.0	2.0

NBF Economics and Strategy

U.S.: FOMC participants' assessment of appropriate monetary policy
Current target range: 0.00%-0.25% (grey area)



NBF Economics and Strategy (data via Federal Reserve)

Fed's 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.

Progress on vaccinations has reduced the spread of COVID-19 in the United States. Amid this progress and strong policy support, indicators of economic activity and employment have strengthened. The sectors most adversely affected by the pandemic remain weak but have shown improvement. Inflation has risen, largely reflecting transitory factors. Overall financial conditions remain accommodative, 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. Progress on vaccinations will likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remain.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation having run 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, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals. These asset purchases help foster smooth market functioning and 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; Thomas I. Barkin; Raphael W. Bostic; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Mary C. Daly; Charles L. Evans; Randal K. Quarles; and Christopher J. Waller.

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Paul-André Pinsonnault
Senior Economist
paulandre.pinsonnault@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

David Djavidi
Intern Economist
david.djavidi@nbc.ca

Alexandra Ducharme
Intern Economist
alexandra.ducharme@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

Alpa Atha
Fixed Income Economist
alpa.atha@nbc.ca

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