US Federal Reserve Announcement

The Fed came out of the gates fast and furious in support of the economy earlier in the crisis, but today’s announcement included no major policy changes. Rather, the rate-setting committee employed a slightly dovish tone in its statement, in addition to forecasts which painted a picture of both a tepid recovery and a central bank stuck at its effective lower bound for an extended period of time.

In the statement, policymakers advised investors that the central bank would continue to purchase Treasury bonds and MBS at least at the current pace, allaying some fears in markets that the bond-buying program was slowing down just as issuance was picking up.

The infamous dot-plot returned to accompany the statement, providing a downbeat forecast of what the economy is expected to look like in the years to come. The projected decline of 6.5% in GDP in 2020 is slightly worse than where our tracking estimate stands, and the median forecast for 2021 of only 5.0% growth after that drop is uninspiring. Policymakers don’t see core inflation hitting its 2% target over the medium-term and also see the unemployment rate still hovering around 5.5% at the end of 2022.

The median projection also did not see any changes in the long-run unemployment rate of 4.1%, which means that the economy would not be at full employment at the end of 2022. It also could mean that policymakers don’t yet see clear signs of long-lasting scars on employment opportunities. That was echoed in the longer-run expectations for GDP growth, which were only downgraded by 0.1%pt.

As a result, the FOMC sees the economy operating with enough spare capacity by the end of 2022 to see the fed funds rate still pinned down at the effective lower bound of 0.125%. That view appears to be widely shared, with only two dots higher than that for the year. Notably, no committee member expected the appropriate policy rate path to include negative rates. There were also no changes to the longer-run expectations for the fed funds rate.

Overall, the statement and projections suggest the Fed will likely need to deploy additional easing measures, but likely wants to wait until the fiscal outlook becomes a bit clearer. Indeed, policymakers gave few hints of what changes could occur, leaving ample scope for flexibility.

Chairman Powell was asked about this during his press conference. He stated that the committee is looking to get a better sense of the trajectory for the economy and which tools would be best to deploy. The potential tools include a more concrete statement on forward guidance and yield-
curve control. The aggressiveness of any new policies will in part hinge on how much additional fiscal stimulus is deployed. Waning fiscal support would put more pressure on the central bank to step up. However, Powell has in the past advocated for Congress to implement more fiscal support for the economy.