INVESTMENT STRATEGY GROUP
FOMC COMMENTARY

Janney

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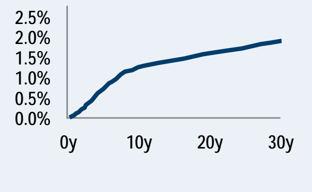
GIMME THREE STEPS TOWARD THE DOOR?

- The Federal Reserve held steady its target for overnight rates to a range of 0 – 0.25%, as they have for more than a year
- There were no material policy changes, and we continue to anticipate zero interest rates through 2022, possibly longer
- Bond buying to continue at the current $120 billion/month pace ($80 billion USTs/$40 billion MBS) with no sign of taper in the text
- The Fed set up standing repo facilities, essentially making permanent a feature of the post-pandemic financing landscape

Treas.	2.15PM	1.45PM	Chg.
3mo	0.05	0.04	+0.00
2yr	0.21	0.20	+0.01
5yr	0.74	0.72	+0.03
10yr	1.26	1.25	+0.01
30yr	1.91	1.91	-(0.00)
3m/2s	17	16	+1
2s/10s	105	105	-(1)
2s/30s	170	171	-(2)



The June FOMC meeting was one that launched a billion flatteners. The combination of Fed policymakers leaving inflation forecasts unchanged, but predicting more rate hikes in 2023 ran smack into 12 months of verbal assurances that rate hikes would be less sensitive to inflation in the coming cycle. In other words, official projections are calling into question Flexible Average Inflation Targeting, FAIT. In response, the yield curve violently flattened, with front-end yields rising slightly and long-end yields falling to their lowest since February. We all knew the Fed would not hike rates or reduce bond buys this meeting—and they did not. The real question at the July FOMC meeting is not about taper timing (as headlines would have you believe), but rather about how aggressively Powell should defend FAIT in his comments.

Economic data since the Fed last met was generally firmer, though directionally in line with recent trends. The June employment report bested expectations with +850K in payroll gains, the best showing since the post-lockdown bounce last August. Retail sales have firmed up even further and are running at a +11% yearly change. Perhaps most importantly, however, the monthly inflation numbers remained very perky, with June's core CPI rising +0.9%, well above expected. A good piece of the increased monthly inflation numbers represent the triumph of rising demand for goods and services against a backdrop of constrained supply, but in particular, shelter expenditures seem to have some upside risk. Given that housing costs represent about a third of various inflation measures, even a 3% trend inflation rate in housing means that core inflation will exceed the 2% mark in 2022, absent an aggregate supply response that holds prices of other goods and services down. That latter hypothetical is possible given how unpredictable inflation dynamics are right now, though it does not intuitively seem likely.

The July FOMC statement was only marginally changed, though there were considerably more edits than in the last few months. In so many words, this meeting is just punting any decisions until the Jackson Hole Symposium in late August, but it seems evident the Fed is edging towards the exit door in terms of extraordinary stimulus. In terms of specific language changes, sectors affected by the pandemic are no longer "weak," but just "have not fully recovered." Economic progress no longer "significantly" depends on COVID infections, but only "depend[s]." Reducing accommodation no longer requires the economy to make "significant progress" towards employment and inflation goals, but "has made progress." These three steps are small ones, though they are consistent with a drift towards the exit.

As a non-interest rates policy addendum, the FOMC also announced two new "standing" repo facilities for providing financing to domestic and foreign financial entities, respectively. These facilities are designed to facilitate orderly functioning in the money markets, and essentially provide a scalable safe haven asset. Lending facilities are not especially relevant in today's excess cash regime, but may prove useful in preventing future financing stress.

Initial market response to the FOMC statement proved muted, with yields marginally higher in the belly of the curve, lower on the long-end, and equities roughly unchanged—though Powell's FAIT commitment should be the biggest market driver today.

FEDERAL RESERVE press release

• Economic language little changed; but pandemic sectors no longer "weak"

• Elevated inflation still "transitory"

• Bond buying continues apace, but FOMC "to assess progress," hinting at taper soon

• Voting was again unanimous

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.

With progress on vaccinations and strong policy support, indicators of economic activity and employment have continued to strengthen. The sectors most adversely affected by the pandemic have shown improvement but have not fully recovered. 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 continues to depend 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. Last December, the Committee indicated that it would 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 its maximum employment and price stability goals. Since then, the economy has made progress toward these goals, and the Committee will continue to assess progress in coming meetings. 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.

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