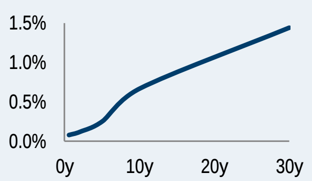
September 16, 2020

WHICH ONE OF YOU FORGOT THE FIREWORKS?

- The Federal Reserve held steady its target for overnight rates to a range of 0 – 0.25%, unchanged for four meetings and many to come
- Recent inflation prints have reduced the Fed's incentive to add further stimulus to the economy, at least for the moment
- While Powell announced the adoption of "average inflation targeting" three weeks ago, there were no further details in today's statement
- The full policy framework review and its adoption remains the next checkpoint for monetary policy, but it's still some weeks away

Treas.	2.15PM	1.45PM	Chg.
3mo	0.10	0.10	+0.00
2yr	0.14	0.14	+0.00
5yr	0.27	0.27	+0.00
10yr	0.68	0.66	+0.01
30yr	1.44	1.41	+0.02
3m/2s	4	4	+0
2s/10s	54	53	+1
2s/30s	130	128	+2



(Source: Janney Investment Strategy Group)

September's FOMC meeting was clearly a dull affair. You can almost imagine the two dozen Fed officials sitting on a Zoom call, just asking one another, "So…what do you want to do?" And, with the economy still digesting the Fed's stimulus from the early stages of the pandemic-triggered recession, the obvious answer for most policymakers was, "Not much." Accordingly, the Fed held overnight interest rates unchanged at the lower bound of 0 – 0.25% and elected not to announce any new or (economically material) changes to any previously announced policy tools. Beneath the surface, the tradeoffs that drive long-term Fed decisions are shifting even while the short-term policy is going nowhere fast.

After weeks of upside surprises, economic data have trended mixed since the Fed met in July. Almost exactly half of the job losses reported during the pandemic have returned through August, but the rebound has slowed noticeably, and there is growing evidence that temporary layoffs are turning into permanent ones. Retail sales (new data just this morning), has meanwhile recovered all of the downturn and appears to be close to equilibrium growth. The housing markets are meanwhile roaring, which has positive implications for intermediate-term consumer spending trends. Perhaps more meaningful for Fed policy at the moment, however, is the trajectory of inflation. Both July and August inflation prints are running a bit hot at 0.6% and 0.4% core CPI, respectively. Inflation is extremely noisy in the short term, but what these data do is, for the moment, reduce pressure for the Fed to act to bring inflation higher. Given that the last round of stimulus is less than 6 months old, the pressure to act is falling, and the costs of not acting are nil, it is hardly surprising to see policy unchanged at the September FOMC meeting.

The statement accompanying today's announcement was both dramatically different and much the same. First, there were no meaningful changes to the assessment of economic conditions (growth "picked up," but still facing "weaker demand"). Next, there was a significant language shift to address the adoption of "Average Inflation Targeting," or AIT. AIT is an approach by which the Fed will attempt to reach 2% inflation on average over some period. Since the economy is starting below the 2% mark, that means, to use the FOMC's words, policy "will aim to achieve inflation moderately above 2% for some time." In other words, the zero interest rate policy currently in place will likely remain in place for longer than is the case in typical cycles. Not everyone was enamored with this approach, as Dallas Fed President Kaplan advocated for a slightly more hawkish language and Minneapolis Fed President Kashkari advocated for more flexibility in language. In addition to the statement, the September meeting included an update to the dot plot—rates on hold through 2023; no surprises there—and summary economic projections. The SEP was slightly more optimistic on current period growth and inflation, and reflected the aforementioned willingness to run inflation a bit hot in 2021 and beyond, at least from some forecasters.

Interest rate market response was fairly muted, with the front end of the yield curve holding unchanged in a signal that today's announcement thus far met expectations. Yields on the long end drifted a bit higher than pre-FOMC levels, and even turned higher on the day by a small margin. All else equal, we would expect AIT policy to steepen the yield curve, but there are too many moving pieces for that one-dimensional an analysis.

FEDERAL RESERVE press release

• The Fed left its mission statement in place, but there were no changes to the economic language

• Forward guidance now explicitly includes a willingness to let PCE inflation rise above 2% to hit an average long run 2% level

• QE Bond buys to remain at "at least" the current pace

• Kaplan dissented to the hawkish side and Kashkari to the dovish side

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 to indicate that it expects to maintain the current target range until core inflation has reached 2 percent on a sustained basis.

- Central tendency growth projections rose from June's meeting
- Some forecasters have PCE inflation above 2% in the forecast horizon without rate hikes—the essence of AIT

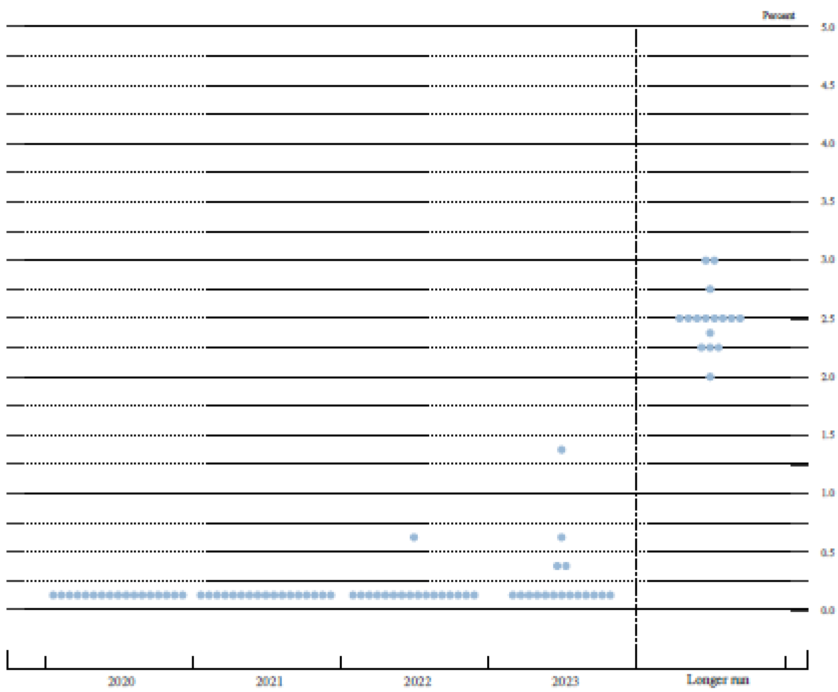
Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, September 2020

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run
Change in real GDP	-3.7	4.0	3.0	2.5	1.9	-4.0–-3.0	3.6–4.7	2.5–3.3	2.4–3.0	1.7–2.0	-5.5–1.0	0.0–5.5	2.0–4.5	2.0–4.0	1.6–2.2
June projection	-6.5	5.0	3.5		1.8	-7.6–-5.5	4.5–6.0	3.0–4.5		1.7–2.0	-10.0–-4.2	-1.0–7.0	2.0–6.0		1.6–2.2
Unemployment rate	7.6	5.5	4.6	4.0	4.1	7.0–8.0	5.0–6.2	4.0–5.0	3.5–4.4	3.9–4.3	6.5–8.0	4.0–8.0	3.5–7.5	3.5–6.0	3.5–4.7
June projection	9.3	6.5	5.5		4.1	9.0–10.0	5.9–7.5	4.8–6.1		4.0–4.3	7.0–14.0	4.5–12.0	4.0–8.0		3.5–4.7
PCE inflation	1.2	1.7	1.8	2.0	2.0	1.1–1.3	1.6–1.9	1.7–1.9	1.9–2.0	2.0	1.0–1.5	1.3–2.4	1.5–2.2	1.7–2.1	2.0
June projection	0.8	1.6	1.7		2.0	0.6–1.0	1.4–1.7	1.6–1.8		2.0	0.5–1.2	1.1–2.0	1.4–2.2		2.0
Core PCE inflation[4]	1.5	1.7	1.8	2.0		1.3–1.5	1.6–1.8	1.7–1.9	1.9–2.0		1.2–1.6	1.5–2.4	1.6–2.2	1.7–2.1	
June projection	1.0	1.5	1.7			0.9–1.1	1.4–1.7	1.6–1.8			0.7–1.3	1.2–2.0	1.2–2.2		
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.1	0.1	0.1	2.5	0.1	0.1	0.1	0.1–0.4	2.3–2.5	0.1	0.1	0.1–0.6	0.1–1.4	2.0–3.0
June projection	0.1	0.1	0.1		2.5	0.1	0.1	0.1		2.3–2.5	0.1	0.1	0.1–1.1		2.0–3.0

- The dot plot includes 2023 dots for the first time, but no real surprises
- Most likely course of policy is no change in rates through 2023, though the markets have largely priced this expectation

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



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