

FOMC Recap: The Unanimous Jackson Hole Consensus Lasted Three Weeks

- Policy stayed on hold as expected
- Dissenters returned
- About one-quarter of FOMC members expect a first hike in 2023
- Positive forecast revisions to growth and inflation
- Statement codified longer-run goals

If having the kids back in school across many regions already has you thinking that late August seems so long ago, then apparently the FOMC agrees. While all policy instruments were left unchanged as expected, the airtight consensus that emerged on August 27th–28th when Chair Powell released the revised Statement on Longer-Run Goals and Monetary Policy Strategy at the annual Jackson Hole symposium sprang a little bit of a leak today. It still generally holds, just a touch less so.

Stocks lost some ground once the dust had settled following the statement and press conference that lasted just over an hour. The S&P500 initially gained ½% following the statement but then closed down by ½%. The USD appreciated a touch on a DXY basis. The US 10 year Treasury yield rose 2.5bps. It isn't clear this was all due to the Fed reaction as the Information Technology sector turned lower starting toward the beginning of the press conference and led the S&P lower.

There were several ways in which a little less cohesion at the fringes and other changes injected somewhat more uncertainty toward the Fed's commitments.

a) Dissenters return: There has not been a dissenting vote on the FOMC since the March 15th meeting when Loretta Mester preferred a 50bps cut instead of a full percentage point. This time there were two. Neel Kashkari dissented because he appears to prefer remaining on hold until 2% inflation has been achieved on a sustained basis instead of language describing a moderate overshoot for some time. Dallas President Kaplan dissented because he wishes to have greater policy rate flexibility beyond the point at which the goals laid out in the new policy strategy statement have been achieved. Their first speeches following today's communications may further elaborate including Rosengren on September 23rd.

b) Dots: The revised dot plot (chart 1) shows continued unanimous agreement toward no rate change this year or next and slightly more agreement toward no rate change in 2022 as only one now forecasts a hike that year instead of two back in the June projections. The insertion of 2023 forecasts for the first time shows four out of 17 FOMC members forecasting hikes for a not inconsequential almost one-quarter of the committee. So much for "We're not even thinking about thinking about raising rates" at least in the minds of these participants. The long run rate projection and the dispersion around it was unchanged.

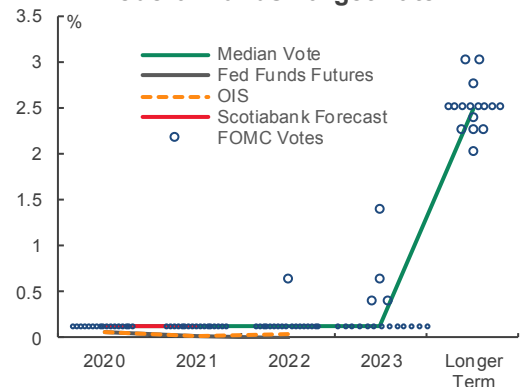
c) Forecast revisions: Each of the growth and inflation projections were revised upward as shown in the accompanying summary table. The pace of contraction

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

Chart 1

September FOMC Projections for the Federal Funds Target Rate



Note: OIS & Fed Fund Futures as of Sept 16th, 2020.
Sources: Scotiabank Economics, US Federal Reserve.

this year was reined in and Chair Powell acknowledged during the press conference that the recovery has proceeded faster than anticipated thus far.

d) Statement language changes: It wasn't certain that the Fed would codify the changes to its longer run goals in today's statement, but it was probable that they would and they did so. The statement openly refers to aiming to hit 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."

e) Purchase guidance: The statement itself could have gone more aggressive on the motives behind Treasury and MBS buying and did not. It is still primarily about sustaining smooth market functioning and helping to foster accommodative financial conditions. Powell's press conference nevertheless did note that buying \$120B of Treasuries (US\$80B) and MBS (US\$40B) per month is driven by broader motives than market repair.

Nevertheless, because **we are just under seven weeks away from the Presidential election**, it may be difficult to fully evaluate FOMC communications including openness to policy alterations in either direction. History tends to indicate that—barring exigent circumstances—the Fed stays out of things this close to an election, let alone this election! The next FOMC statement won't be delivered until after the election on November 5th and even that one may be a quiet affair until some time passes.

Other core messages included noting that despite progress through a quicker than expected recovery, there is still a lot of spare capacity and half of all lost payroll positions remain unemployed. Powell observed that three-quarters of household spending has been recovered, housing has returned to its level at the start of the year and there are some signs of progress in business investment. He once again repeated that the virus remains a dominant uncertainty and was fairly direct in calling for further fiscal stimulus while evading questions regarding its optimal composition that are best left for Congress. Powell observed that the Fed is not out of ammo, but nevertheless repeated that there are limits to monetary policy such as the power to lend but not grant and that fiscal policy may be more effective.

COMPLEMENTARY MATTERS

Several complementary lines of questioning in the press conference may be of added usefulness.

When probed about **financial stability concerns**, Powell noted they have been around throughout the post-GFC period but never really materialized, that they are paying attention but that monetary policy is not the first line of defence as opposed to regulations, supervision, stress testing, high capital/liquidity requirements and macpru tools.

I thought one of the better questions was **whether the FOMC truly believed its ability to engineer higher inflation** when its core PCE forecast only hits and never crosses 2% even by 2023. Powell was somewhat evasive when he said it will simply take some time to get above 2%. Of course, sensible people wouldn't really hold anyone to macro forecasts that far out so we'll cross that bridge when we get to it. Nevertheless, markets are priced for basically one outcome here and that is little inflation and no hikes for years to come so pick your tail.

Powell implied that FOMC members likely do **incorporate expectations for fiscal stimulus** in their committee forecasts because he said that failure to reach agreement over an additional stimulus package would "certainly be a downside risk" and that individual FOMC members have done what they think is appropriate. Translation? The next forecasts in December could downgrade expectations if no deal is struck.

When questioned about incorporating income inequality and housing affordability considerations into what the Fed does, Powell answered that they are doing constant research on such matters and how they affect the recovery but that monetary policy "can't get at those things through our tools. Our tools are broad and can't target particular groups."

I liked Powell's response when **asked if we don't get a vaccine until well into 2021** (or later..) what does that do to the economy? He noted that social distancing, mask wearing, cheap and rapid testing etc could still open up areas of the economy and a lot of workforces across the country.

Powell refused to address a question about stress tests saying he had nothing to offer today.

Powell was asked **what is wrong with the design or function of the Main Street Lending Program** given its trivial size. He offered a multi-part answer:

- Firms are not indicating credit constraints as the main problem, so maybe its usefulness was overstated;
- Some lenders are concerned about the underwriting expectations and feel they should underwrite the loans as they would others;
- It's a facility for companies that don't have access to alternative borrowing and otherwise why would we need it? Many do face alternatives;
- many businesses are still shut down and can't service a loan so they need fiscal support instead;
- Powell would not comment on allegations that Treasury is saying to banks they should target zero losses in the mainstreet programs while Boston Fed President Rosengren said it should be up to Congress to decide that.

When asked about targeting assistance to commercial real estate, Powell rightly noted their powers are only indirect. The Fed cannot target particular sectors directly, but their facilities take CRE securities and the Main Street facility helps them pay their rent while CMBS spreads have tightened. Further, he noted that covenants often prohibit taking on more debt which is an impediment to providing more direct support.

Please see the accompanying statement comparison. The original statement can be found [here](#) and the original forecasts can be found [here](#).

The Federal Reserve Board Members and Presidents Median Economic Projections

	Dec '19 Projection	Jun '20 Projection	Sep '20 Projection
Real GDP			
2020	2.0	-6.5	-3.7
2021	1.9	5.0	4.0
2022	1.8	3.5	3.0
2023			2.5
Longer Run	1.9	1.8	1.9
Unemployment Rate			
2020	3.5	9.3	7.6
2021	3.6	6.5	5.5
2022	3.7	5.5	4.6
2023			4.0
Longer Run	4.1	4.1	4.1
PCE Inflation			
2020	1.9	0.8	1.2
2021	2.0	1.6	1.7
2022	2.0	1.7	1.8
2023			2.0
Longer Run	2.0	2.0	2.0
Core PCE Inflation			
2020	1.9	1.0	1.5
2021	2.0	1.5	1.7
2022	2.0	1.7	1.8
2023			2.0
Federal Funds Rate			
2020	1.6	0.1	0.1
2021	1.9	0.1	0.1
2022	2.1	0.1	0.1
2023			0.1
Longer Run	2.5	2.5	2.5

Note: Real GDP and both inflation measures are Q4 y/y % changes, while the unemployment rate and Federal funds rate are Q4 EoP.

Sources: Scotiabank Economics, US Federal Reserve

RELEASE DATE: SEPTEMBER 16, 2020

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,

RELEASE DATE: JULY 29, 2020

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 coronavirus outbreak is causing tremendous human and economic hardship across the United States and around the world. Following sharp declines, ***economic activity and employment have picked up somewhat*** 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 weigh heavily on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term. In light of these developments, the Committee decided to maintain the target range for the federal funds rate at 0 to 1/4 percent. The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.

The Committee will continue to monitor the implications of incoming information for the economic outlook, including information related to public health, as well as global developments and muted inflation pressures, and will use its tools and act as appropriate to support the economy. In determining the timing and size of future adjustments to the stance of monetary policy, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

To support the flow of credit to households and businesses, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency residential and commercial mortgage-backed securities at least at the current pace to sustain smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions. In addition, the Open Market Desk will continue to offer large-scale overnight and term repurchase agreement operations. The Committee will closely monitor developments and is prepared to adjust its plans as appropriate.

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; Robert S. Kaplan; Neel Kashkari; Loretta J. Mester; and Randal K. Quarles.

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