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TRENDMACRO LIVE!

On the September FOMC

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The recovery now V-shaped, yet "dot-plots" ease. But Powell carps about fiscal stimulus.

Today's FOMC statement eliminates key forward guidance that the Fed will stay accommodative "until it is confident that the economy has weathered recent events." In its place is a lengthy and repetitive explication of the new inflation "make-up strategy" revealed several weeks ago at Jackson Hole (see "Powell at Jackson Hole, and the Inflation Makeup Strategy" August 27, 2020).

> "With inflation running persistently below this longer-run goal [i.e. 2 percent], 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…"

- Did we mention 2 percent?
- This drew two dissents from FOMC member, the first since the March FOMC. Dallas Fed President Robert Kaplan wanted to retain the "confident the economy has weathered" language, and Minneapolis Fed President Neel Kashkari who, best as we can tell, objected to the failure to characterize the inflation target as pertaining to "core."

The Summary of Economic Projections of FOMC participants significantly upgraded expectations for the pace of recovery this year – with GDP upgraded from -6.5% to -3.5%, the unemployment rate from 9.3% to 7.6% and core inflation from 1.0% to 1.5% (see "Data Insights: Federal Reserve" September 16, 2020). In other words, the FOMC is agreeing with us that the recovery is looking pretty V-shaped.

- *Yet in the same SEP, there is no upgrade to the expected policy rate path, indeed the "dot plot" for 2022 is slightly easier now than it was in March* (again, see "Data Insights: Federal Reserve").
- As chair Jay Powell pointed out in the post-meeting press conference, there isn't any notable expectation of "liftoff" until 2023. That new "dot plot" was published for the first time today, and even in that case it is only 4 participants out of 17.
- *This shows the Fed's willingness to let the economy "run hot," enabled by its abandonment of Phillips Curve logic and its replacement by a tolerance for inflation overshoots* (again, see

Update to strategic view

US FED, US MACRO: The SEP upgraded GDP, unemployment and inflation, pointing to a V-shaped recovery. At the same time, the "dot-plots" got more dovish. The language about maintaining accommodation until the Fed is "confident" that the virus crisis has past is gone, replaced by a lengthy explanation of the new inflation "make-up strategy." We see all this as reflecting a new framework in which the Fed will let the economy "run hot," tolerating inflation overshoots. Oddly, the SEP shows no such overshoot. As always, Powell takes the bloom off in the press conference by carping about the need for more fiscal stimulus.

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"Powell at Jackson Hole, and the Inflation Makeup Strategy").

- That's the functional reality of policy, meeting by meeting. But perhaps the FOMC participants don't really believe they will ever have to face a moment when they have to tolerate an inflation overshoot. The SEP shows GDP settling in at the "new normal" growth rate of 2.5% in 2023, but inflation only rising to 2% by then, without any overshoot in the meantime.

The statement reiterated the intention to maintain asset purchases at present levels, adding the purpose is to "help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses" (for the full red-line, see "Data Insights: Federal Reserve" September 16, 2020).

- *Market chatter that the Fed would announce new longer-maturity targets for these purchases came to nothing*. Such maturity-extension would have turned these purchases into true quantitative easing; the new descriptive language seems designed to be sure it is not seen as such.
- Powell was asked in the press conference about maturity-extension to make the asset purchases "more stimulative." He stammered out a boilerplate answer about the possibility for adjustments in the future – stopping his non-answer literally in mid-sentence without ever mentioning maturity-extension specifically.
- *The message here is that the Fed is very happy with its existing programs and its new inflation "make-up strategy," and has no appetite for even considering anything else for a while.*
- *Market chatter that the Fed would expand or extend its special crisis lending programs also came to nothing*. No surprise to us there, considering that less than $200 billion of their $2.3 trillion capacity has been taken up (see "On the Fed's Massive Intervention" March 23, 2020).

All this was bullish enough to sustain a moderate risk-on mood in markets through the first 23 minutes of the press conference. Powell took the bloom off, as it seems he always does, by saying for the umpteenth time that he believes "more fiscal support is likely to be needed."

- Powell went on to explain that he believes there is a general consensus that more fiscal stimulus is coming. He himself seems to agree, with the only question for him being "when, how much, and what will be the contents. If we don't get that, then there would certainly be downside risks."
- We don't see why the market should take his particular views on this any more prescient than anyone else's. And we doubt the market failed to read the new statement language that the Fed is "prepared to adjust the stance of monetary policy as appropriate if risks emerge."

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Bottom line

The SEP upgraded GDP, unemployment and inflation, pointing to a V-shaped recovery. At the same time, the “dot-plots” got more dovish. The language about maintaining accommodation until the Fed is “confident” that the virus crisis has past is gone, replaced by a lengthy explanation of the new inflation “make-up strategy.” We see all this as reflecting a new framework in which the Fed will let the economy “run hot,” tolerating inflation overshoots. Oddly, the SEP shows no such overshoot. As always, Powell takes the bloom off in the press conference by carping about the need for more fiscal stimulus.