U.S. FOMC Review

- FOMC: a germ of forward guidance on QE; an inconsequential change in the dot plot

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FOMC

The policy statement of the Federal Open Market Committee involved only one modification: an element of forward guidance on the current quantitative easing program. The Committee in the past provided no information on its plans for QE, but today's statement indicated that the Fed would continue to purchase at least $80 billion of Treasury securities and at least $40 billion of mortgage-backed securities per month "until substantial further progress has been made toward the Committee's maximum employment and price stability goals."

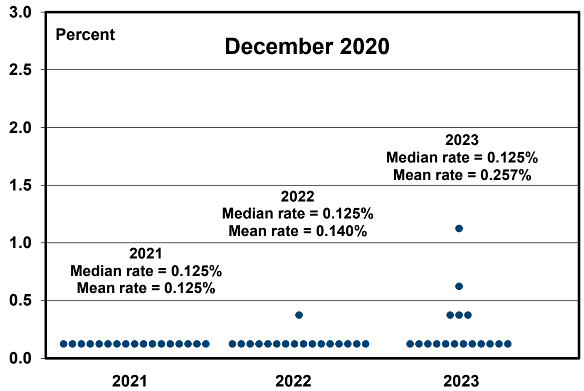
We did not find the additional guidance especially edifying, as it left one wondering how to interpret the meaning of "substantial further progress". A reporter at the press conference asked Mr. Powell to provide clarity, but the Fed Chair was not willing to offer a specific set of metrics. At the same time, his response to this question and others implied that Mr. Powell viewed the effort as providing a significant degree of accommodation and that officials planned to continue the program for some time. He also noted that the FOMC would announce plans for tapering well in advance of any pullback.

The summary of economic projections changed slightly, with growth prospects firmer than previously believed. The median forecast for economic growth over the four quarters of 2020 now stands at -2.4 percent, up from -3.7 percent in the September projections. Given the results in the first three quarters of the year, this four-quarter projection implies an expectation of GDP growth of approximately 4.5 percent in the fourth quarter. Expectations for economic growth in 2021 and 2022 are now 0.2 percentage point firmer than previously expected, and expectations for the unemployment rate were trimmed. Expected inflation rates changed modestly (see table, next page).

We saw a strong possibility of a slightly hawkish shift in the dot plot because of a brighter economic outlook, but the new plot showed only modest changes, and the shifts could be viewed as dovish. Specifically, the one official expecting a rate hike in 2022 now expects a smaller change (25 basis points to 0.375 percent rather than 50 basis points to 0.625 percent). Similarly, one of the four dots showing tighter policy in 2023 was reduced by 25 basis points. The new plot had only one hawkish tilt: there are now five officials expecting higher interest rates in 2023 versus four officials in September.

We did not receive a great deal of information today, but the latest signals show an exceptionally dovish FOMC. There is no end in sight for QE, and the Committee plans to hold short-term interest rates close to zero for several years.

FOMC Rate View: Year-End 2021, 2022, & 2023*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2021, 2022, and 2023. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but two governorships were open at the December 2020 meeting.*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2020

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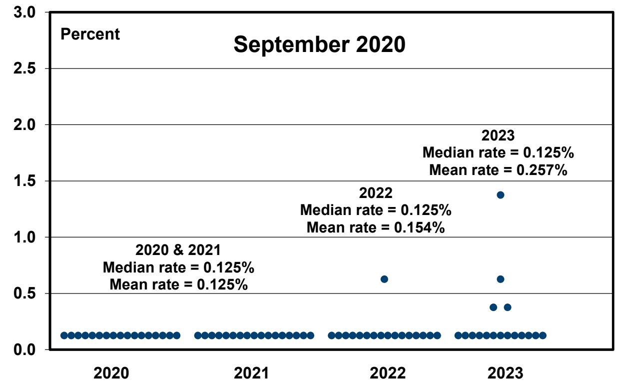

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Economic Projections of the FOMC, December 2020*

	2020	2021	2022	2023	Longer Run
Change in Real GDP	-2.4	4.2	3.2	2.4	1.8
September projection	-3.7	4.0	3.0	2.5	1.9
Unemployment Rate	6.7	5.0	4.2	3.7	4.1
September projection	7.6	5.5	4.6	4.0	4.1
PCE Inflation	1.2	1.8	1.9	2.0	2.0
September projection	1.2	1.7	1.8	2.0	2.0
Core PCE Inflation	1.4	1.8	1.9	2.0	--
September projection	1.5	1.7	1.8	2.0	--
Federal Funds Rate	0.1	0.1	0.1	0.1	2.5
September projection	0.1	0.1	0.1	0.1	2.5

** Median projections*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2020