FOMC Remains Prepared To Do “Whatever It Takes”

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Fed Will Remain in Accommodative Mode For Quite Some Time

As widely expected, the Federal Open Market Committee (FOMC) made no major policy changes at its meeting today. That said, the committee left little doubt that it is prepared to do whatever it can to help return the U.S. economy to some semblance of “normal.” Indeed, the FOMC noted in the first line of its statement that it “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 committee’s view that the “virus and the measures taken to protect public health have induced sharp declines in economic activity and a surge in job losses” is expressed in its forecasts. Specifically, the FOMC sees real GDP contracting 6.5% over the course of 2020 (top chart), with the unemployment rate still exceeding 9% in Q4-2020. Although the committee looks for GDP to rebound 5.0% in 2021, it still looks for the unemployment rate to end 2021 at 6.5%. In other words, the pandemic has caused the U.S. economy to fall into a deep hole, and it will take a few years to crawl out. With the rate of PCE inflation expected to remain well below the Fed’s target of 2% through 2022, the committee is in no hurry to hike rates.

In that regard, the so-called “dot plot,” which shows individual forecasts of committee members, suggests that the FOMC will likely be on hold through 2022. As shown in the middle chart, no members believe that a rate hike would be appropriate this year or next year, and only two FOMC members believe that a rate hike would be appropriate in 2022. The committee also expressed its commitment to continue to provide policy accommodation by announcing that it “will increase its holdings of Treasury securities and agency residential and commercial mortgage-backed securities at least at the current pace.” The Fed’s balance sheet has already ballooned since the pandemic struck, and it will continue to swell in the future (bottom chart).

In short, the FOMC seems prepared to do “whatever it takes” to help the economy climb out of its pandemic-induced crater. That said, it made no reference to negative rates. As we wrote in a recent report, we do not think Fed policymakers want to go negative due to potential deleterious effects that negative rates could have on the U.S. financial system. In addition, the committee did not make any reference to yield curve control (i.e., explicit targets for long-term interest rates). If the economy is not “on track to achieve” the FOMC’s “maximum employment and price stability goals,” then the committee will dig deeper into its tool kit to find ways to support economic activity. Although negative rates and yield curve control are in that tool kit, we believe the committee will opt to use other tools first.

Source: Federal Reserve Board and Wells Fargo Securities