FOMC Remains Committed To Use All of Its Tools

The FOMC did not make any major policy changes today, but it remains committed to use all of its tools, if necessary. The committee did extend the Fed’s swap lines with foreign central banks.

No Major Changes Announced by FOMC Today
As widely expected, the Federal Open Market Committee (FOMC) did not make any major policy changes at its meeting today. Market participants universally expected that the committee would keep its target range unchanged at 0.00% to 0.25%, which the committee supported unanimously. The FOMC also announced that it would continue to buy U.S. Treasury securities and mortgage-backed securities (MBS) at the current monthly pace of $80 billion and $40 billion, respectively. The FOMC said that it continues to stand ready to provide liquidity to the financial system through repurchase agreements (repos), although there has not been much demand for repo transactions by financial institutions in recent weeks.

In our view, the statement that the FOMC released was dovish. The committee continued to stress that the economy is very weak at present by noting “economic activity and employment have picked up somewhat in recent months but remain well below their levels at the beginning of the year.” Furthermore, the FOMC acknowledged that the outlook is highly uncertain and “will depend significantly on the course of the virus.”

As it did at the June 10 policy meeting, the FOMC opened today’s statement by stating that it “is committed to using its full range of tools to support the U.S. economy in this challenging time.” These tools include the very low setting of interest rates, purchases of financial assets (i.e., quantitative easing) and other measures to support the credit markets, all of which the Fed is employing at present. However, there was no explicit mention of “forward guidance” in today’s statement. As we discussed in more detail in our recent FOMC “Flashlight” report, we think that the committee will wait until its strategic review is finished before adopting some form of explicit forward guidance. Given our outlook for continued elevated unemployment (top chart) and benign inflation (middle chart), we feel confident that the FOMC will adopt some form of explicit forward guidance at either its September 16 policy meeting or its meeting on November 5.

Foreign Currency Swap Lines Extended
The FOMC also announced that it would extend the temporary swap lines and repurchase agreements that it put in place with foreign central banks through March 2021. These liquidity facilities were instrumental in easing strains in dollar funding markets earlier this year. As shown in the bottom chart, the amount of foreign currency swaps outstanding shot up to nearly $450 billion in late May, but the swaps have been rolling off the Fed’s balance sheet subsequently as they have matured. In our view, the FOMC’s decision to extend these temporary facilities should help to keep strains in dollar funding markets at bay, which should reduce the probability of spikes in the value of the dollar, everything else equal.

Source: U.S. Department of Labor, U.S. Department of Commerce, Federal Reserve Board and Wells Fargo Securities