Fed static but average inflation targeting still remains fuzzy

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Highlights:

As Nelson Mandela once said, "there is nothing like returning to a place that remains unchanged to find the ways in which you yourself have altered".

The US Federal Reserve kept its policy settings static for the fourth consecutive meeting, leaving its Fed Funds Target Rate at 0-0.25% and maintaining its asset purchase program monthly pace at US$80b and US$40b for UST bonds and mortgage-backed securities respectively. The FOMC statement also reiterated the central bank's commitment to keep effectively zero interest rates out into the foreseeable future, which is now extended beyond 2022 to 2023. So a legitimate question one would ask is what is there not to like about such a dovish Fed? However, the market reaction was telling – equities back-pedalled on initial gains, the UST yield curve steepened a tad, while the USD is trading a tad firmer this morning, perhaps attributable to the absence of more explicit dovish cues such as expanding the asset purchase program pace, targeting the longer-dated yield curve or yield curve control.

Terminology matters: Elaborating on the average inflation targeting framework over time, the FOMC statement 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". But what exactly is the Fed's assessment of "maximum employment" and how will they define "moderately exceed" and "some time" for the inflation overshoot? These questions were left unanswered for now. But the timeframe has clearly shifted from the Fed being anticipatory of inflation upticks to being reactive to inflation overshoots with a undefined time lag. This "zero for longer" mindset is obviously conducive for risk-taking, but may have disappointed the market doves at this juncture.

Dissension, but still dovish: Kaplan and Kashkari stood out in the unanimous vote with their comments suggesting their preference for an even more dovish tilt. Kaplan "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, but prefers that the Committee retain greater policy rate flexibility beyond that point" whereas Kashkari prefers "that the Committee to indicate that it expects to maintain the current target range until core inflation has reached 2 percent on a sustained basis."

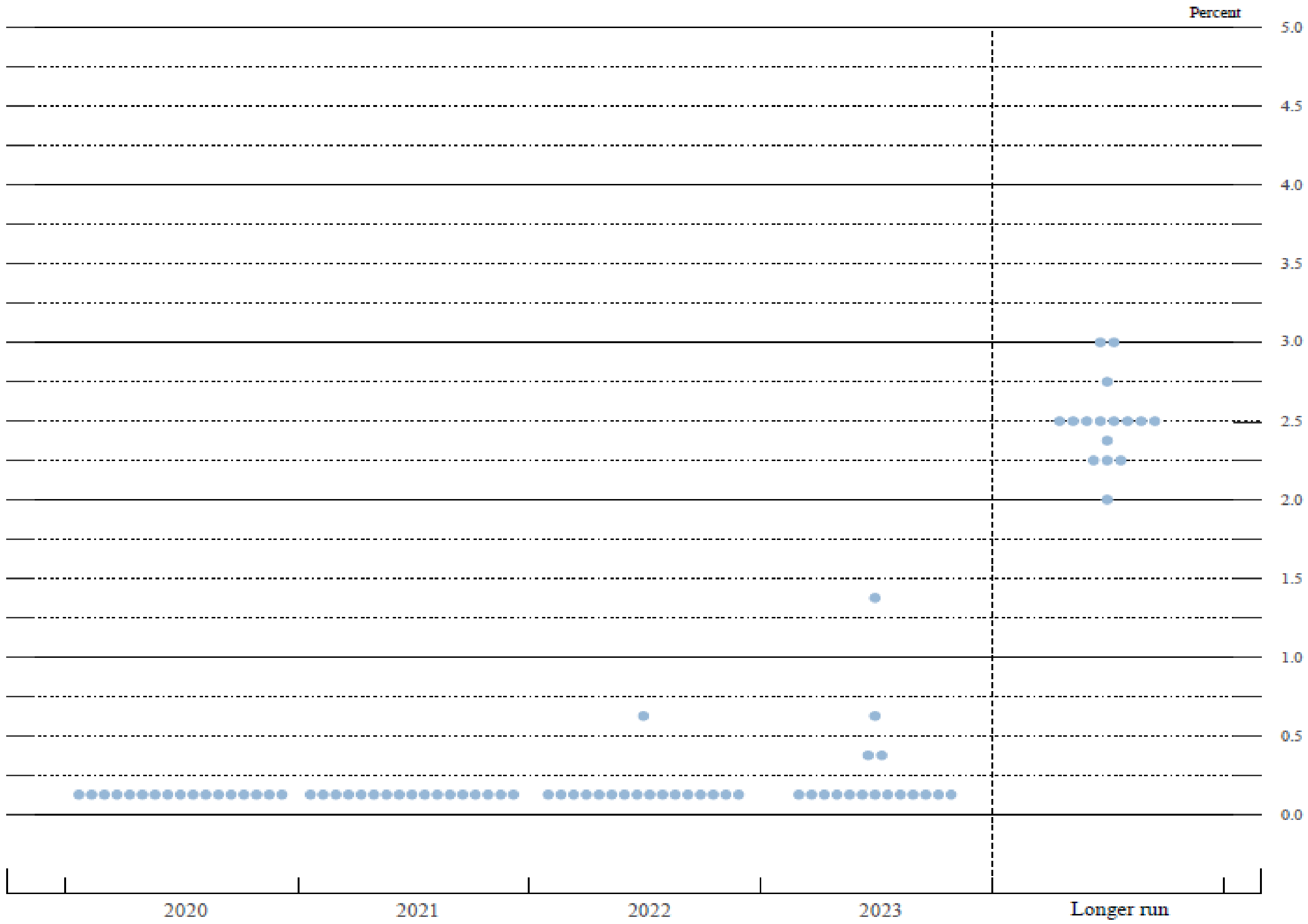
Economic forecasts point to a less severe 2020 prognosis and a more gradual recovery to 2023. The Fed's projections reflect upward adjustments to their 2020 forecasts, namely GDP growth (-3.7% versus -6.5% in June), unemployment (7.6% versus 9.3%) and core PCE inflation (1.5% versus 1.0%), but with a milder 2021 growth rebound (4.0% versus 5.0%) and both headline and core PCE inflation does not return to 2% until 2023. This is consistent with the recent OECD forecasts that point to a milder 2020 global recession story, with the US tipped to see a 3.8% contraction. Interestingly, the Fed will also take into account a wide range of inflation including readings on public health (which is surely music to president Trump's ears in the run-up to the approaching US elections) in addition to the usual labour market conditions, inflation pressures and inflation expectations, and financial and international developments.

The dots plot also shed very little light for the road ahead. Even though one Fed member is looking for a hike in 2022 and four members are more hawkish in 2023, the policy direction remains very much outcome driven depending on the inflation and unemployment mandates at that juncture. Moreover, Fed Chair Powell said at the press conference that fiscal support is still needed. While president Trump has urged Senate Republicans to "go for the higher numbers" to break a deadlock over the $1.5t stimulus bipartisan House proposal, it remains to be seen if the fiscal impasse can be broken anytime soon. With the Fed staying on hold for the foreseeable future so as to not rock the boat ahead of the November elections, the implications for the S'pore market are also muted – SGS yields and swap are 1-2bps softer led by the longer tenors, while short-term interest rates such as the 3-month SIBOR and SOR will likely remain anchored around the 0.4% and 0.17% handles respectively.

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run	2020	2021	2022	2023	Longer run
Change in real GDP	-3.7	4.0	3.0	2.5	1.9	-4.0–-3.0	3.6–4.7	2.5–3.3	2.4–3.0	1.7–2.0	-5.5–1.0	0.0–5.5	2.0–4.5	2.0–4.0	1.6–2.2
June projection	-6.5	5.0	3.5		1.8	-7.6–-5.5	4.5–6.0	3.0–4.5		1.7–2.0	-10.0–-4.2	-1.0–7.0	2.0–6.0		1.6–2.2
Unemployment rate	7.6	5.5	4.6	4.0	4.1	7.0–8.0	5.0–6.2	4.0–5.0	3.5–4.4	3.9–4.3	6.5–8.0	4.0–8.0	3.5–7.5	3.5–6.0	3.5–4.7
June projection	9.3	6.5	5.5		4.1	9.0–10.0	5.9–7.5	4.8–6.1		4.0–4.3	7.0–14.0	4.5–12.0	4.0–8.0		3.5–4.7
PCE inflation	1.2	1.7	1.8	2.0	2.0	1.1–1.3	1.6–1.9	1.7–1.9	1.9–2.0	2.0	1.0–1.5	1.3–2.4	1.5–2.2	1.7–2.1	2.0
June projection	0.8	1.6	1.7		2.0	0.6–1.0	1.4–1.7	1.6–1.8		2.0	0.5–1.2	1.1–2.0	1.4–2.2		2.0
Core PCE inflation[4]	1.5	1.7	1.8	2.0		1.3–1.5	1.6–1.8	1.7–1.9	1.9–2.0		1.2–1.6	1.5–2.4	1.6–2.2	1.7–2.1	
June projection	1.0	1.5	1.7			0.9–1.1	1.4–1.7	1.6–1.8			0.7–1.3	1.2–2.0	1.2–2.2		
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.1	0.1	0.1	2.5	0.1	0.1	0.1	0.1–0.4	2.3–2.5	0.1	0.1	0.1–0.6	0.1–1.4	2.0–3.0
June projection	0.1	0.1	0.1		2.5	0.1	0.1	0.1		2.3–2.5	0.1	0.1	0.1–1.1		2.0–3.0

FOMC participants' assessment of appropriate monetary policy:



Source: FOMC

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