Fed pledge ‘durable’ guidance and hold rates at least 3 years

The US Federal Reserve in its September 2020 Federal Open Market Committee (FOMC) statement has pledged to keep policy rates unchanged at the target range for federal funds rate at 0 to 0.25% (median at 0.1%) until at least 2023. It also reaffirmed its recent policy tweak for a ‘durable’ guidance towards inflation which will allow overshooting of its target in order to steer the US economy to recovery as its primary goal.

The FOMC said that it will maintain the target range until “labour market conditions have reached levels consistent with the committee's assessments of maximum employment and inflation has risen to 2% and on track to moderately exceed 2% for some time” under the new average inflation targeting (AIT) approach with the emphasis on "broad and inclusive" employment.

The decision was however not unanimous (8-2 vote) with Dallas Fed President Robert Kaplan dissenting as he wanted to retain “greater policy rate flexibility” while Minneapolis Fed President Neel Kashkari wanted the Fed to explicitly state that it will maintain the current target range until “core inflation has reached 2% on a sustained basis.”

The FOMC summary also noted that “the ongoing public health crisis will continue to weigh on economic activity, employment and inflation in the near term and poses considerable risks to the economic outlook over the medium term.”

Fed Chair Jerome Powell said the US economic outlook remains fraught with uncertainties and that the Fed remains committed to using full range of tools and will aim to achieve inflation moderately above 2% for some time. He also repeated the Fed’s stance the importance of fiscal measures to support jobs and incomes, noting that it would be a while before economic activities and employment return to pre-pandemic levels.

Smaller US GDP contraction

Nevertheless, the Fed did note that the US economy was recovering faster than expected and is now projecting an economic contraction of 3.7% for 2020 compared with a decline of 6.5% previously; while predicting that US unemployment will end the year at 7.6% (previous 9.3%).

However, the growth rebound in 2021 is moderated to 4% (previous forecast: 5.0%) and to 3% in 2022 (previous 3.5%) while unemployment will ease to 5.5% (previous 6.5%) in 2021 and to 4.6% (previous 5.5%) in 2022. Longer-term unemployment forecast was unchanged at 4.1% which suggests that the Fed does not see the pandemic causing permanent damage to the US economy for now although the road to recovery is still expected to drag beyond 2022 or at least till 2023.

As to the possibility of inflationary pressures, it maintained that “weaker demand and significantly lower oil prices are holding down consumer price inflation.” Fed officials foresee rates staying ultra-low through 2023 based on the median projection of their quarterly forecasts, although four officials penciled in at least one hike in 2023.

The Fed also kept the pledge to increase its holdings of Treasury securities and agency mortgage-backed securities (MBS) at least at the current pace in order to support credit flow to households and businesses in the coming months. The central bank said it will maintain its monthly purchases at US Treasuries at US$80 billion and MBS at US$40b with the option to increase holdings as needed to “sustain smooth functioning of markets for these securities.”

Going forward, we are of the view that the Fed will likely stay out of the limelight ahead of the US elections on 3 November. There is no FOMC policy meeting in October and the next will only take place on 4/5 November.

In terms of US growth outlook and the backdrop of recent stronger-than-expected US economic data and the upwardly revised FOMC's GDP projection, the 3Q rebound is likely to be better than what we first projected a few months ago. We are now projecting a more robust 21.6% (annualised rate) rebound in 3Q followed by +7.4% in 4Q. While this points to a stronger 2H rebound, it will not fully offset the 1H contraction which saw an unprecedented 31.7% 2Q contraction. Hence, US full-year 2020 GDP is now expected to contract by 4.5% (from previous estimate of -5.8%).

BOJ maintains rates policy

Meanwhile, in other central bank news, the Bank of Japan (BoJ) has kept its monetary policy steady on Thursday keeping both short- and long-term rates unchanged. It added that current policy settings will remain as long as necessary to maintain 2% inflation target and will not hesitate to ease further if needed. The BOJ noted that while the Japanese economy has started to pick up, it remains in "a severe situation" due to the impact of the coronavirus pandemic at home and abroad.

Japan's new Prime Minister Suga Yoshihide has voiced his support for the BOJ governor Haruhiko Kuroda, as well as to continue the policies under his predecessor Shinzo Abe which include a combination of aggressive fiscal and monetary policies often referred to as Abenomics.

We have not changed our view and expect the BOJ to do more and enhance its monetary easing stance in 2H20, most likely through increasing its Japanese government bond (JGB) purchases and expanding its lending facilities to corporates and small and medium-sized firms/enterprises (SMEs) while the purchasing of exchange-traded funds (ETF), Japan real estate investment trusts (J-REITs) and corporate bond may be enhanced (at a later date). We also do not expect the BOJ to cut policy rates further into negative territory.

For more details, click on

o *FOMC statement (Sep 2020)*
o *BOJ MPM statement (Sep 2020)*

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