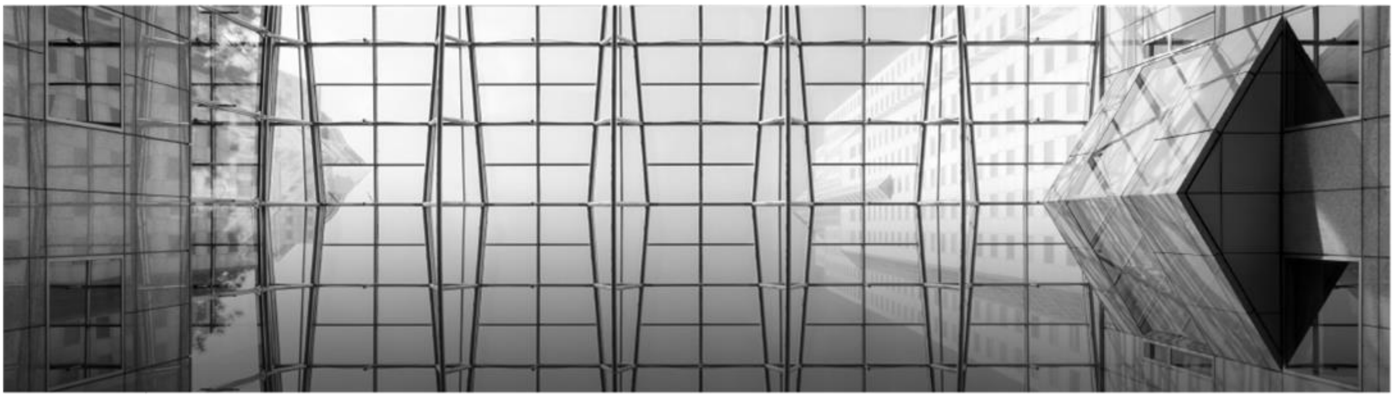

US Fed keeps rates unchanged and QE unlimited tools intact

The US Federal Reserve has maintained its pledge to keep its policy rates within the 0.0%-0.25% range (0.1%) until at least 2022 as well as Treasury purchases at US$80 billion a month and mortgage-backed securities at US$40 billion.

Following the latest Federal Open Market Committee (FOMC) meeting on Wednesday, the US central bank reaffirmed that the target range will be kept until it is confident that the US economy has weathered the coronavirus (Covid-19) pandemic and on track to achieve its maximum employment and price stability goals.

To drive the message that the policy rate will be pegged low for a long time, Fed chairman Jerome Powell reiterated that the central bank is not “even be thinking about raising rates.”

In short, the Fed is signalling that it will continue to do whatever it takes, beyond interest rate cuts and asset buying, to ensure financial market stability. At the height of the volatility and liquidity crunch in March, it was buying Treasuries at a pace of U$75 billion per day to stabilise government debt markets compared to currently about $22.5 billion a week.

According to its own projections, US GDP is expected to contract by 6.5% in 2020 while unemployment will end the year at 9.3%. Growth is expected to rebound by 5.0% in 2021 with unemployment easing to 6.5% in 2021 and 5.5% in 2022. Inflation is expected to rebound in 2021-2022 but will be below its 2% objective with no projections of any deflation, shot-term or otherwise.

Despite the severity of the downturn caused by COVID-19, the Fed’s growth projections suggest that it does not see the pandemic causing enduring damage to the US economy although the road to recovery has been extended beyond 2022.

Growth outlook – technical recession

Going forward, we expect the Fed to act decisively to prevent the financial market from compounding the ill effects from COVID-19 impact to the real economy and US households while keeping its near zero percent policy rate until at least 2022 without seeing the need to press rates lower into negative territory.

Its latest guidance reaffirms our view that yields at the front end of the curve will stay low for an extended period. The monetary stance to aid economic recovery will be picked up by longer maturity bonds. In other words, the Fed is likely to cap front-end rates but not long-end rates which will reinforce the current steepening yield trend.

In terms of US growth outlook, we now expect a 35.2% (annualised) decline in 2Q after contracting 5% in 1Q due to the Covid-19 impact surfacing only in March, or back-to-back quarters of declines which is the definition of a technical recession, and a severe one at that. The projected second-half rebound (+16.5% in 3Q and 11.7% in 4Q) will not offset the 1H contraction. Our estimate is that the full-year 2020 GDP will contract by 5.8% (vs the previous estimate of minus 5%) barring any serious Covid-19 second wave outbreaks.

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