July Fed minutes point to disappointing outlook and guidance

The minutes from the July 2020 Federal Open Market Committee (FOMC) meeting released on 20 August were less than confidence-boosting with dampened prospects of a 2H20 robust recovery as the coronavirus (COVID-19) pandemic was seen as “posing considerable risks to the economic outlook over the medium term."

In its assessment, the US Federal Reserve (Fed) noted that “in light of the significant uncertainty and downside risks associated with the course of the pandemic and how long it would take the economy to recover, an acceleration of the coronavirus outbreak with another round of strict limitations on social interactions and business operations” would lead to “a decrease in real GDP, a jump in the unemployment rate, and renewed downward pressure on inflation next year.”

The FOMC participants noted that while there was a sizable rebound in consumer spending, there had been less improvement in the business sector, adding that while the economy and jobs "had picked up somewhat," the path of economy still hinges on the "highly uncertain" path of the virus.

The US central bank also did not indicate a clear timeline for its rate guidance. Stepping back from its earlier readiness to set a clearer bar for raising interest rates, which would underscore the commitment to an extended period of ultra-loose monetary policy, a number of participants said that providing greater clarity on a likely future path of rates would be appropriate “at some point.”

This was seen as a shift away from doing so at upcoming meetings, especially the September FOMC on 15-16 September. It was also a subtle change from the previous minutes which indicated that policy makers were keen to sharpen their forward guidance “at upcoming meetings.” The previous June meeting had included discussions over commitment to holding rates near zero until specific thresholds for inflation or unemployment, or both were reached.

Participants agreed that refining the statement was warranted in light of "fundamental changes" in the economy over the past decade including low interest rates and "persistent disinflationary pressure.” Their view was that the overall effect of the COVID-19 pandemic on prices was disinflationary. Several participants suggested that additional accommodation may be required to promote economic recovery and return inflation to 2%.

Yield curve control less likely in September FOMC

Most of the policymakers were less enthusiastic about yield curve control (YCC) as they judged yield caps and targets (YCT) would likely provide “only modest benefits in current environment.” Noting that there were associated costs to yield caps, targets, including rapid expansion of balance sheet, they judged that yield caps and targets are “not warranted” now but should remain an option in the future. Overall, the minutes were seen as providing a less optimistic outlook for 2H 2020 and disappointing in that the Fed did not provide clarity on what and when is their next move.

Nevertheless, the latest FOMC minutes did not change the Fed’s commitment to do “whatever it takes” to maintain financial market stability and guide the US economy to recovery. It also does not change expectations for the Fed to keep its near zero percent policy rate until at least 2022. The absence of any discussion on negative policy rates continues to reaffirm the view that the Fed is not even considering pushing rates into negative territory as a policy option. But at the same time, the minutes failed to provide more details of the anticipated loosening of the Fed Reserve’s inflation targeting strategy nor any support for the implementation of yield curve control as the next policy tool to make monetary policy even more accommodative. As such, we have now revised our expectations and no longer expect YCT to be announced as a policy tool anytime soon. We think the Fed will maintain status quo for its policy interest rate and overall policy stance at next FOMC in September..

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