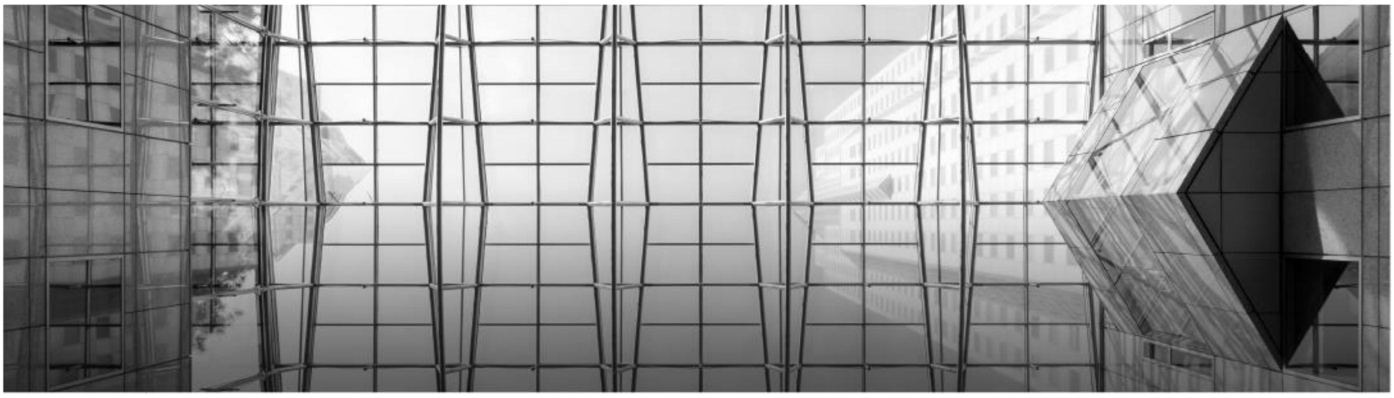

FOMC: Lack of fiscal stimulus will set back US recovery

The Federal Open Market Committee (FOMC) minutes from the September meeting have highlighted the consequential impact of the lack of an US fiscal stimulus if the US economic recovery is to be sustained. It warned that the Fed's economic outlook had hinged on additional fiscal support and that the pace of recovery could be slower than anticipated. It is an oft-repeated message from many senior Fed officials including FOMC Chair Jerome Powell in recent weeks.

As to the new strategy of Average Inflation Targeting (AIT), he said the guidance given in the September FOMC is "durable" and that "there did not appear to be a need for enhanced forward guidance at this juncture or much scope for forward guidance to put additional downward pressure on yields."

In recent remarks to the National Association for Business Economics (6 Oct), Mr Powell had called for continued aggressive fiscal and monetary stimulus for an economic recovery that he said still has "a long way to go." While noting progress made in job creation, goods consumption and business formation among other areas, he added that now would be the "wrong time" for policymakers to take their foot off the gas and that the risks of "overdoing it" seem to be smaller.

Powell added that "even if policy actions ultimately prove to be greater than needed, they will not go to waste. The recovery will be stronger and move faster if monetary policy and fiscal policy continue to work side by side to provide support to the economy until it is clearly out of the woods."

Main Takeaways

1) The main takeaway was that the US economy was recovering better than expected mainly due to the fiscal help provided earlier by Congress and that it is very important for the US government's continued provision for more fiscal stimulus to support the US economy. The latest minutes noted that "prior fiscal policy actions were seen as having supported the ability and willingness of households to spend although most participants expressed concern about the expiry of the enhanced unemployment insurance benefits from the CARES Act (Coronavirus Aid, Relief, and Economic Security Act) and judged that additional fiscal relief would help sustain the recovery in household spending."

2) Many FOMC participants noted that "their economic outlook assumed additional fiscal support and that if future fiscal support was significantly smaller or arrived significantly later than they expected, the pace of the recovery could be slower than anticipated." They generally expected spending on services to remain subdued for some time, restraining pace of recovery and that "the absence of further fiscal support would exacerbate economic hardships in minority and lower-income communities."

3) Members are satisfied with "providing more explicit outcome-based forward guidance for the federal funds rate that included establishing criteria for lifting the federal funds rate above the current level near zero in terms of the paths for employment or inflation or both" but "with longer-term interest rates already very low, there did not appear to be a need for enhanced forward guidance at this juncture or much scope for forward guidance to put additional downward pressure on yields." That disappointed some sections of the markets that were looking to the FOMC minutes for specific benchmarks that the FOMC will use as criteria for the recently announced AIT strategy.

In a virtual conference held on Wednesday (7 Oct), New York Fed President John Williams had further clarified that it that the Fed's pledge to keep interest rates at zero until inflation is on track to "moderately" exceed 2% is overly vague and left much up to the Fed’s judgment. Mr Williams said “moderate isn’t a number, it’s a guardrail” against expectations that the Fed would tolerate very high or persistently high inflation.

Outlook

Going forward, while we believe the Fed policy will continue its call for more fiscal stimulus. Beyond that, it will likely stay out of the limelight ahead of the 3 November US Presidential elections. There is no FOMC policy meeting in the month of October and the next FOMC will be right after the US presidential elections (3 Nov, Tuesday) on 04/05 November 2020.

In line with the Fed’s inflation targeting approach with emphasis on "broad and inclusive" employment, the September FOMC has effectively confirmed a shift to a prolonged low rates era. We expect the Fed to keep its near zero percent policy rate until at least 2023. We continue to hold the view the Fed will not want to push rates beyond zero, into negative territory.

Note that the advanced first estimates of 3Q 2020 GDP is due on 29 Oct 2020, a few days before the elections and November FOMC, which will now likely see an unprecedented rebound in US GDP.

Important Notice & Disclaimers

UOB Asset Management (Malaysia) Bhd 199101009166 (219478-X)

To find out more,
please visit www.uobam.com.my

RIGHT BY YOU