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Don't count on fiscal policy

FOMC Post-Meeting Comment

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Summary

- The FOMC kept monetary policy unchanged, even the statement regarding monetary policy was identical to last time.
- During his press conference, Powell noted that in recent months the pace of recovery has moderated and that it may take continued support from monetary and fiscal policy.
- Although votes are still being counted, it appears that we should not count on fiscal policy to provide much support to the economic recovery in the next two years. The FOMC are on their own at a time when monetary policy options are almost depleted.

No change in policy

The FOMC kept monetary policy unchanged. The FOMC statement repeated that the path of the economy will depend significantly on the course of the virus and made some minor adjustments[1] to a few sentences on the economy. The FOMC statement remained unchanged regarding monetary policy. The decision to keep policy unchanged and release this statement was unanimous. Daly voted as an alternate member at this meeting instead of Kashkari who was absent because of paternity leave (at least this was something new at the Fed). During his press conference, Powell – who had a recurring throat problem – noted that in recent months the pace of recovery has moderated and that it may take continued support from monetary and fiscal policy. He also announced that going forward, i.e. starting in December, the full details of the FOMC projections will be released simultaneously with the FOMC statement. What's more, two new charts will be added showing how risk assessments have changed over time.

Don't move

In this Election Week the Fed would have come into action only if there was some kind of market panic. However, as markets have behaved in an orderly manner the best thing for the Fed was to stay on the sidelines in this politically sensitive period. During his press conference, Powell also said he was reluctant to get into the elections. He was also careful when he talked about fiscal policy, not wanting to prescribe Congress what to do. However, he made clear that the support provided by the CARES Act to the economy was substantial and that the recovery would be stronger if we get more fiscal support when Congress finds that appropriate.

[1] Economic activity and employment have *continued to recover* (September: picked up in recent months). Weaker demand and *earlier declines in* (Sept: significantly lower) oil prices have been (Sept: are) holding down consumer price inflation. Overall financial conditions *remain accommodative* (Sept: have improved in recent months).

On their own

While the votes are still being counted, it looks like we are heading for two years of gridlock on Capitol Hill. The Democrats are holding on to their majority in the House of Representatives, but the Republicans appear to maintain their majority in the Senate (although we may not be sure until early January). This means that we should not expect major fiscal policy measures, at least until the 2022 midterms. Only in case of major economic downturns are we going to see the two parties come together and repeat the joint effort that we saw with the CARES Act. This means that as long as there is no emergency the Fed will be on its own supporting the economic recovery from the Covid-19 crisis. This comes at a time that the Fed's monetary policy arsenal is close to depleted.

Out of ammo

Powell denied that the Fed had run out of ammunition and said that the parameters of the asset purchase program could be changed. In fact, one of the discussions during this FOMC meeting was about these parameters. Moreover, the Fed could also make changes to its special lending facilities or come up with new facilities. No mention of yield curve control here, but if asset purchases and special lending facilities fail to do the trick if the economy falls back again substantially that would be the Fed's only option, given their unwillingness to consider negative policy rates. However, given how low longer-term rates are already, this will provide only modest support to the recovery. So yes, the Fed has almost run out of ammunition.

Table 1: Rabobank forecast of federal funds rate path

FOMC meeting	*Decision*	*Target range for the federal funds rate (%)*
29 Jan 2020		1.50-1.75
3 Mar 2020 (Emergency meeting)	50 bps cut	1.00-1.25
15 Mar 2020 (Emergency meeting)	100 bps cut	0.00-0.25
19 Mar 2020 (Notation vote)		0.00-0.25
23 Mar 2020 (Notation vote)		0.00-0.25
31 Mar 2020 (Notation vote)		0.00-0.25
29 Apr 2020		0.00-0.25
10 Jun 2020		0.00-0.25
29 Jul 2020		0.00-0.25
27 Aug (Notation vote)		0.00-0.25
16 Sept 2020		0.00-0.25
5 Nov 2020		0.00-0.25
16 Dec 2020		0.00-0.25

Source: Rabobank

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