US Fed policy – No changes in rates and liquidity support; economic outlook revised

Contact:

Madan Sabnavis
Chief Economist
madan.sabnavis@careratings.com
+91-22-6837 4433

Author:

Sushant Hede
Associate Economist
sushant.hede@careratings.com
+91-22-6837 4348

Mradul Mishra (Media Contact)
mradul.mishra@careratings.com
+91-22-6754 3573

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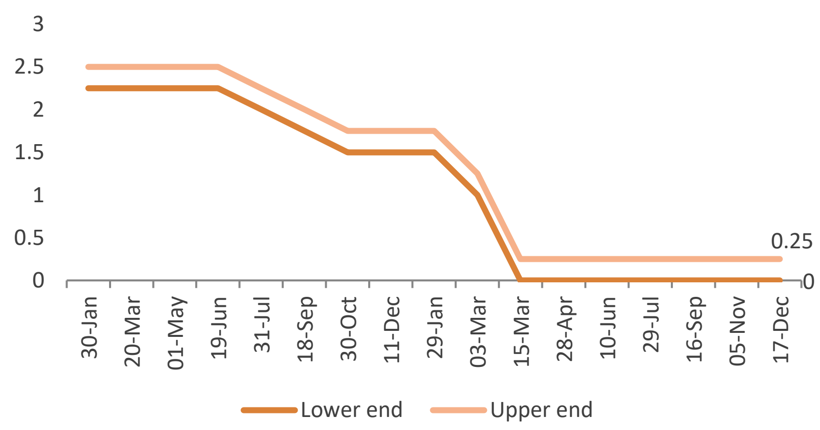
The Federal Reserve's Open Market Committee (FOMC) unanimously decided to maintain the federal fund rate at **0 – 0.25%** in its last credit policy for 2020. The Committee asserted that it will be appropriate to maintain the policy rates in this target range until labour market conditions are consistent with the assessment of maximum employment and inflation averages 2% over time. It also expects to maintain an ***accommodative stance*** until these outcomes are achieved. The FOMC continues to believe that the outlook for the US economy is uncertain and depends on the course of the virus. However, based on the faster than expected recovery and developments around the vaccine, the FOMC members have **revised the economic outlook upwards** for the US economy from their September projections.

This is the **sixth policy meeting when the Committee has decided to maintain status qu**o after slashing the Federal fund rates from 1.5-1.75% to 0-0.25% in the month of March 2020 following the outbreak of the coronavirus pandemic. The FOMC projects the policy rates to remain at 0-0.25% till 2023.

Chart 1: Movement in federal fund rate (%)



Source: Federal Reserve

Assessment of the US economy:

- Economic activities in the US economy continue to recover from the depressed Q2-2020 level. **Real GDP growth** for the US economy was estimated to contract by 2.9% in Q3-2020, significantly narrower than the (-)9% de-growth recorded in Q2-2020. However, in recent months, the pace of improvement has moderated on account of a sharp increase in the coronavirus cases in the US.

- The household spending on goods (especially durable goods) has been robust but the spending on services continues to be bleak (Especially travel and hospitality).

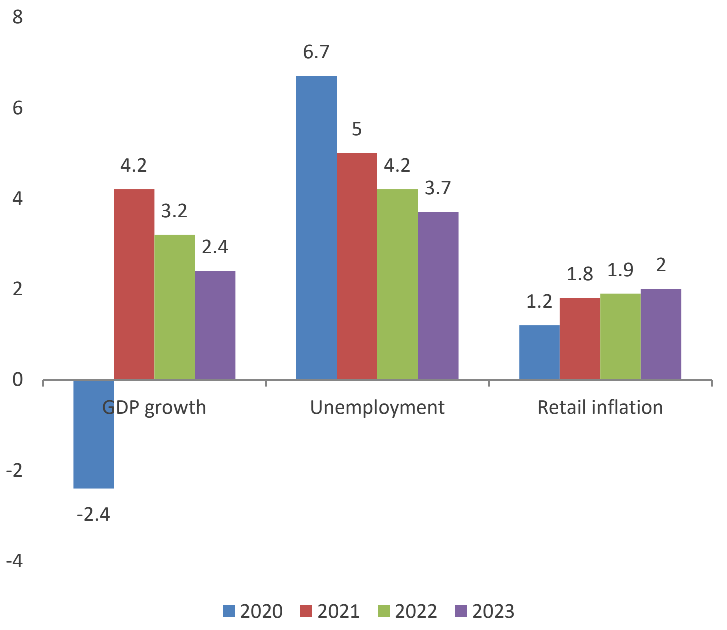
- The recovery has progressed quicker than expected and the FOMC has **revised upwards the economic growth forecast to (-)2.4%** in 2020 compared with (-)3.7% made in the September 2020 projections.
- The overall economic activity remains well below its level before the pandemic and the path ahead remains highly uncertain.
- The pace of improvement in the labor market has moderated to some extent. Job growth in non-farm payrolls has slowed down from 711,000 in September to 245,000 in November. The unemployment rate has declined at a gradual pace but remains elevated at 6.7%.
- Inflation continues to remain benign owing to weaker demand and earlier fall in crude oil prices. Inflation stood at 1.2% in November 2020, lower than the inflation target of 2%. Prices have remained soft for the sectors which have been most adversely affected by the pandemic.

Liquidity measures to continue:

- The US Fed has been purchasing sizeable quantities of Treasury and agency mortgaged-backed securities, which are vital for credit flow in the economy.
- The US Fed is purchasing holdings of Treasury securities and agency mortgage-backed securities at $120 bn per month - $80 bn per month of Treasury and $40 bn of mortgage backed securities. ***This is likely to continue until substantial further progress has been made towards maximum employment and price stability goals.***
- In addition, large-scale overnight and term repurchase agreement operations will also continue.

Outlook on the US economy: The outlook of the US economy has undergone a revision compared with the September 2020 projections.

Chart 2: Economic projections of US Federal Reserve –(%)



Source: Federal Reserve

- The outlook is extraordinarily uncertain and is contingent on the course of the virus. The FOMC believes that the news about the vaccine is positive but also highlights the significant challenges and uncertainties regarding the production and distribution of the vaccine.
- The path forward will also depend on the fiscal support by the Government as well.
- **GDP growth projections** for the US economy have been sharply **revised upwards from (-)3.7% to (-) 2.4% in 2020**. The projections for 2021 and 2022 have been revised only marginally upwards.
- **Retail inflation projection** is retained at the same level as September projections at 1.2%. Inflation for 2021 and 2022 is projected to be just below the 2% target and 2% for 2023.
- **US unemployment rate** is projected to improve to improve to 6.7% in 2020 compared with 7.6% in the September projections. The projections are estimated to decline gradually to 3.7% in 2023.

Market Reactions

The US equity markets (US Dow -0.15%, NASDAQ +0.5%, S&P 500 +0.18%) have been mixed as the gains owing to an upward revision in the outlook for the US economy and sustained accommodative stance by the US Federal Reserve was capped as investors awaited a potential fiscal economic stimulus package. **US 10 year benchmark treasury yields** ended flat at 0.92% as the US Fed continued with its monthly bond-buying program.

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022. CIN: L67190MH1993PLC071691
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457
E-mail: care@careratings.com I Website: www.careratings.com I CIN: L67190MH1993PLC071691

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