All Signal, No Noise

MARKET ANALYSIS

MNI Fed Preview: September 2020

Meeting Dates: Tue-Wed, 15-16 September
Decision/Statement/Summary of Econ Projections: Wed 16 September at 1400ET / 1900BST
Press Conference/Q&A: Wed 16 September at 1430ET / 1930BST

Minutes: Wed 7 October

Links (likely URLs based on previous meetings):
Statement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200916a.htm
SEP/Dot Plot: https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20200916.htm
Implementation note (if applicable):
https://www.federalreserve.gov/newsevents/pressreleases/monetary20200916a1.htm
Press Conference: https://www.federalreserve.gov/monetarypolicy/fomcpresconf20200916.htm

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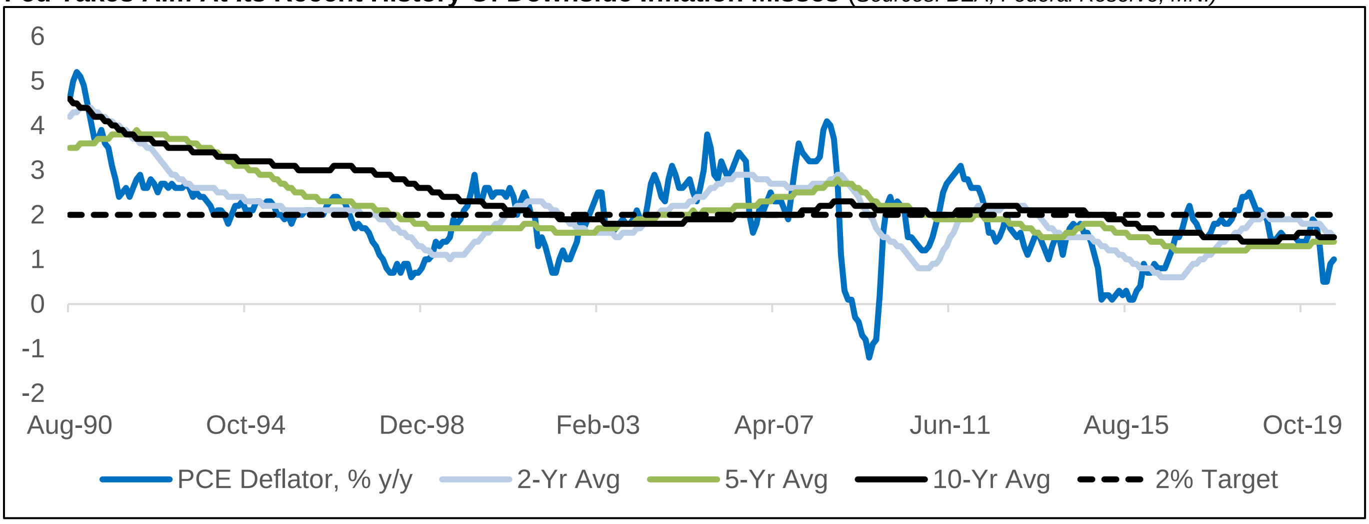
MNI POV (Point Of View): How Long Is “For Some Time”?

By Tim Cooper

The September FOMC is less ‘live’ in terms of potential new action from the Fed than it seemed even a few weeks ago, but there is still plenty at stake. We will get the first set of 2023 economic projections from the Committee, and Powell is set to face a barrage of questions on the new flexible average inflation targeting (AIT) regime and on the FOMC’s current outlook on the economy. We’ll probably also get some modest changes in language in the statement to reflect the completion of the framework review / AIT, and perhaps on the intent of the Fed’s asset purchase program (but any substantial changes to the pace / maturity of purchases would be a major surprise).

Fed Takes Aim At Its Recent History Of Downside Inflation Misses (*Sources: BEA, Federal Reserve, MNI)*



The key event since the July FOMC was on August 27 at the Jackson Hole symposium, where Chair Powell unveiled key changes to the Fed's policy framework, with the inclusion in the longer-run monetary policy statement of a flexible make-up strategy for inflation, and a more broad-based interpretation of the 'maximum' level of employment. The Fed is effectively saying it will no longer pre-emptively raise rates/tighten policy merely on the basis of an expected increase in inflation due to employment reaching some 'maximum' level.

Markets were already largely priced for this (the rate path had already been flatlined at zero out through 2023), and since the July FOMC, rate expectations for the next few years have barely changed (**see p 5**). This has not gone unnoticed by the FOMC. Since the July meeting, several Committee members (and the July meeting minutes) have pushed back against the notion that they were close to consensus on adopting a strengthened forward guidance policy or adjusting asset purchases, saying they wanted to get a better sense of the economic outlook given such uncertain times (**see the Fed Communications section, p. 6-8**).

This is in line with MNI's Policy Team's exclusive reporting since July that that officials are reluctant to deliver new forward guidance in September because they are just starting the process of debating its exact form after concluding an 18-month review of its policy framework.

Against this backdrop, the number of sell-side analysts who expect action to be taken on guidance/asset purchases at the September meeting has fallen from 15 to a mere 4 since July (**see p.4**). FOMC officials appear to believe that the information contained in the funds rate dot plot, when combined with other communications, have and will continue to do the job of conveying the Fed's commitment to rates remaining at the zero lower bound for a few years at least. They also take the very flat rate path implied by markets as justification for not rushing the implementation of much stronger forward guidance. Indeed, it is hard to see what such an adjustment would accomplish at this stage, and the Fed may consider it wiser to save that particular bullet for a time when the market has begun to pre-emptively price in liftoff.

Economic Projections: Watch 2023 Numbers And Longer-Run Estimates

The new Summary of Economic Projections bears attention. It is firm consensus that the median 'dot' for Fed funds will remain at zero through end-2023. And it would be a surprise if the Fed didn't upgrade its near-term growth, employment and inflation forecasts at this meeting, since the numbers have been better-than-expected since the last set at the June FOMC. But the 2021 and 2022 expectations may show some expectations of retracement, especially considering Congress is floundering on the fiscal front (a topic that has been of concern to Powell and his colleagues, who have repeatedly stressed the importance of fiscal stimulus over the summer).

JUNE 2020 FOMC: Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy. Source: Federal Reserve

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2020	2021	2022	Longer run	2020	2021	2022	Longer run	2020	2021	2022	Longer run
Change in real GDP	-6.5	5.0	3.5	1.8	-7.6–-5.5	4.5–6.0	3.0–4.5	1.7–2.0	-10.0–-4.2	-1.0–7.0	2.0–6.0	1.6–2.2
December projection	2.0	1.9	1.8	1.9	2.0–2.2	1.8–2.0	1.8–2.0	1.8–2.0	1.8–2.3	1.7–2.2	1.5–2.2	1.7–2.2
Unemployment rate	9.3	6.5	5.5	4.1	9.0–10.0	5.9–7.5	4.8–6.1	4.0–4.3	7.0–14.0	4.5–12.0	4.0–8.0	3.5–4.7
December projection	3.5	3.6	3.7	4.1	3.5–3.7	3.5–3.9	3.5–4.0	3.9–4.3	3.3–3.8	3.3–4.0	3.3–4.1	3.5–4.5
PCE inflation	0.8	1.6	1.7	2.0	0.6–1.0	1.4–1.7	1.6–1.8	2.0	0.5–1.2	1.1–2.0	1.4–2.2	2.0
December projection	1.9	2.0	2.0	2.0	1.8–1.9	2.0–2.1	2.0–2.2	2.0	1.7–2.1	1.8–2.3	1.8–2.2	2.0
Core PCE inflation[4]	1.0	1.5	1.7		0.9–1.1	1.4–1.7	1.6–1.8		0.7–1.3	1.2–2.0	1.2–2.2	
December projection	1.9	2.0	2.0		1.9–2.0	2.0–2.1	2.0–2.2		1.7–2.1	1.8–2.3	1.8–2.2	
Memo: Projected appropriate policy path												
Federal funds rate	0.1	0.1	0.1	2.5	0.1	0.1	0.1	2.3–2.5	0.1	0.1	0.1–1.1	2.0–3.0
December projection	1.6	1.9	2.1	2.5	1.6–1.9	1.6–2.1	1.9–2.6	2.4–2.8	1.6–1.9	1.6–2.4	1.6–2.9	2.0–3.3

Furthermore, the longer-run forecasts bear watching for any changes. The longer-run inflation median is unlikely to be adjusted (it is, after all, still the longer-term target). But for unemployment, it is unclear whether the 4.1% median in the Jun FOMC will be adjusted based on the framework review's emphasis on the employment mandate, and a further signal that NAIRU – conceptual in nature as it is – may be somewhere much lower than previously considered (some on the sell-side see the longer-run unemployment rate being removed from the table altogether). And for the Fed funds rate long-run median, some see the 2.50% from the June SEP being downgraded slightly. In other words, changes on this front would almost certainly be to the dovish side.

Chair Powell, How Long Is "For Some Time"?

Powell will face a barrage of questions at the post-meeting press conference related to his Jackson Hole speech. While he is likely to spend a good deal of time discussing the findings of the framework review, below is a list of sell-side questions they expect/hope Powell will answer. Many focus on the vague language in the new long-run statement (the new inflation goal does not define terms such as "moderately above", "for some time", and "averages" – intentionally, to give the Fed flexibility, which is why Powell may defer/deflect on such questions).

- When will the new framework begin to apply (does the inflation undershoot of the previous few years need to be made up, or do we start now?)
- If inflation is persistently above 2% for a period of time, will the Fed attempt to tighten policy to get inflation back below 2% (i.e. 'undershoot') for a period of time?
- What magnitude/length of time is the Fed willing to see inflation overshoot 2%?
- What will the Fed do to boost inflation? Is the Fed disappointed that medium/long-term inflation expectations remain well below 2%?
- How and when will the FOMC introduce stronger fwd guidance to clarify the medium-term outlook for asset purchases? (Assuming they don't pull the trigger at this meeting, of course.)
- How does the FOMC see the current fiscal outlook impacting the economic trajectory?

MNI Instant Answers:

The questions that we have selected for this meeting are:

- Changes to Interest Rate Paid on Excess Reserves (IOER) / minimum bid rate on overnight repo?
- Does the statement replace the current reference to its "symmetric 2 percent inflation objective"?
- Does the statement alter language on asset purchases, and/or does the Fed announce changes to purchases with regard to size, duration, and/or conditionality?
- Are there any changes to the longer-run medians in the SEP for Fed funds (in June: 2.5%), Unemployment (4.1%), or Inflation (2.0%)?
- Does the 2023 PCE inflation median in the SEP substantially differ from 2.0%? Higher or Lower?

(Formerly Human Readable Algo) The markets team have selected a subsection of questions we think could be most market moving and will publish the answer to all of these questions within a few seconds of the Fed statement being released. These questions are subject to change; clients will be informed of any changes via our Edge and Bullets services. **A comprehensive list of questions is available on the MNI Monitor (available via the website here:** https://www.marketnews.com/realdisplay?product=AFM

Analyst Views – Fed Outlook

- **Expectations for Fed action at the September FOMC have diminished considerably since June/July.**
- This is partly because the FOMC unveiled its new longer-run strategy and conclusion of its framework review at the Jackson Hole symposium, taking some of the wind out of expectations of such a move in September.
- **But also, FOMC communications / minutes have signalled a willingness to be patient** on implementing a ‘stronger’ form of forward guidance (with more specific thresholds before hiking rates), or changes to the asset purchase program (beyond the expected framing of asset purchases as being for the purpose of monetary accommodation rather than merely to ease market functioning).
- **Of 32 previews seen by MNI, only 4 (Barclays, BNP, Danske, UBS) now expect action in September.** In contrast, prior to the July FOMC, at least 15 saw strengthened forward guidance by September.
- **See summary table below - Bolded entries below indicate expectations of changes at the September FOMC.** all ‘outcome-based’ fwd guidance expectations are inflation-based, unless noted – most still expect this at some point but expectations have become vague.
- ***Full summary of analysts` notes, please see pages 10-17***

Analyst	Strengthened Forward Guidance	Change In Asset Purchase Program
ANZ	Yes, in coming months (not September)	In coming months (not September); to present as QE vs market functioning
Barclays	Yes, in coming months (had previously expected in Sep)	**Yes, in September (modestly lengthen avg duration), as part of presentation as QE vs market functioning**
BNPParibas	**Yes, covering both empl and infl objectives, in Sep**	Not at present; to present as QE vs market functioning
BofAML	Yes, to link hikes to inflation overshoot	Not at present; to present as QE vs market functioning
CIBC	Yes, at some point	
Citi	Yes, December at earliest	Not at present, could consider MBS taper in Dec/later
Credit Suisse	Yes, possibly Dec	Not at present; to present as QE vs market functioning
Danske	**Yes, in September**	**Yes, in September ("increase QE buying")**
Deutsche	Yes, in coming months (not September)	Not at present; to present as QE vs market functioning
Goldman Sachs	Yes, in November	Yes, in November
HSBC	Yes, but not necessarily w specific date/outcome	Not at present; to present as QE vs market functioning
ING	Yes, but "quite a way off"	No
JPMorgan	Yes, in coming months (not September)	Not at present; may present as QE vs market functioning
Morgan Stanley	Yes, in coming months (not September)	Not "near term"
NatWest	Yes, at some point	Not unless significant "bad" increase in long-end yields; to present as QE vs market functioning
Nomura	Yes, by end of year (not September)	Not at present; to present as QE vs market functioning
Nordea	Yes, but later	Possible in Sep
Rabobank	Yes, at some point	
SEB	Yes, at some point	Yes, at some point
Societe Generale	Yes, at some point, though perhaps w/o quantitative targets	
Swedbank	Yes, in coming months (not September)	Yes, in coming months (not September)
TD	Yes, but later	Yes, inc coming months; in Sep, to present as QE vs market functioning
UBS	**Yes, outcome-based, in September**	**Yes, extend Tsy maturities to 5+ yrs, slower pace**
Unicredit	Yes, in Nov or Dec	
Wells Fargo	Yes, at some point	Not at present; to present as QE vs market functioning
Wrightson ICAP	Yes, at some point (not September)	Not at present; to present as QE vs market functioning

Correct to the best of MNI`s knowledge as of Sep 14 mni

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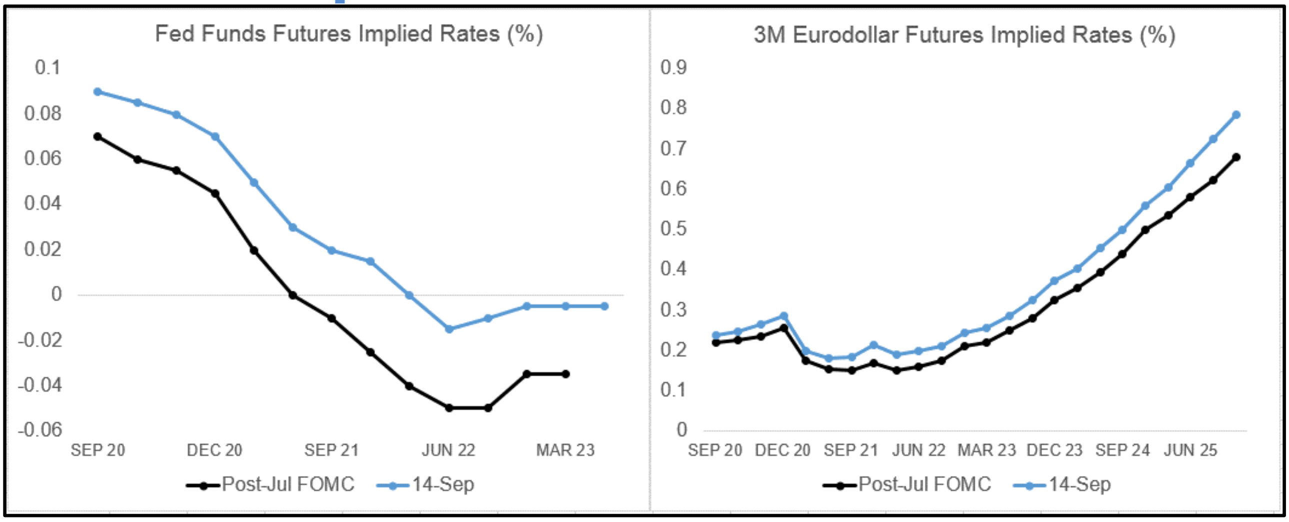
Market-Implied Rate Outlook



Source: Bloomberg, MNI Market News

- The rate path remains very much pinned down, with no Fed hikes fully priced through 2023. While the rate path is very slightly higher than it was immediately following the Jul 29 FOMC announcement, in the broader scheme of things it has stayed basically unchanged, suggesting the market agrees with Fed Chair Powell's exhortation that the FOMC is not even thinking about thinking about raising rates. (*Updated Sep 14)*

mni Central Bank Watch - FED

MNI FED Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	1.3	0.1	↑	2.3	↓					-0.59
PCE Deflator	% y/y	1.0	0.5	↑	1.9	↓					-0.34
UoM 1-Yr Inflation Exp	% y/y	3.1	3.2	↓	2.4	↑					0.95
Inflation Swap 5y/5y	%	2.09	1.74	↑	1.89	↑					1.89
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	56.0	43.1	↑	50.1	↑					0.93
Industrial Production	% m/m	3.03	-12.81	↑	-0.43	↑					0.73
Factory Orders	% m/m	6.4	-13.5	↑	-0.4	↑					0.84
Housing Starts	K	1496	934	↑	1617	↓					0.59
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Corporate Spreads BBB/Baa	bps	1.45	2.02	↓	1.45	→					-0.52
Chicago Fed Financial Con	Index	-0.53	-0.29	↓	-0.37	↓					-0.76
Consumer Credit Net Chg	$bn	12.3	-65.8	↑	10.4	↑					0.52
New Home Sales	K	901	570	↑	774	↑					1.71
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	1.2	-14.7	↑	0.8	↑					0.15
Consumer Confidence	Index	84.8	85.9	↓	132.6	↓					-0.91
Nonfarm Payrolls Net Chg	K	1371	2725	↓	251	↑					0.34
Average Hourly Earnings	% y/y	4.7	6.6	↓	3.0	↑					-0.06
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	3341	3044	↑	2954	↑					2.42
US 10-Year Yield	%	0.66	0.65	↑	1.15	↓					-0.32
US Yield Curve (2s-10s)	bps	53.0	49.2	↑	23.6	↑					1.23
USD TWI	Index	90.82	92.70	↓	91.63	↓					-0.80

Source: MNI, Bloomberg

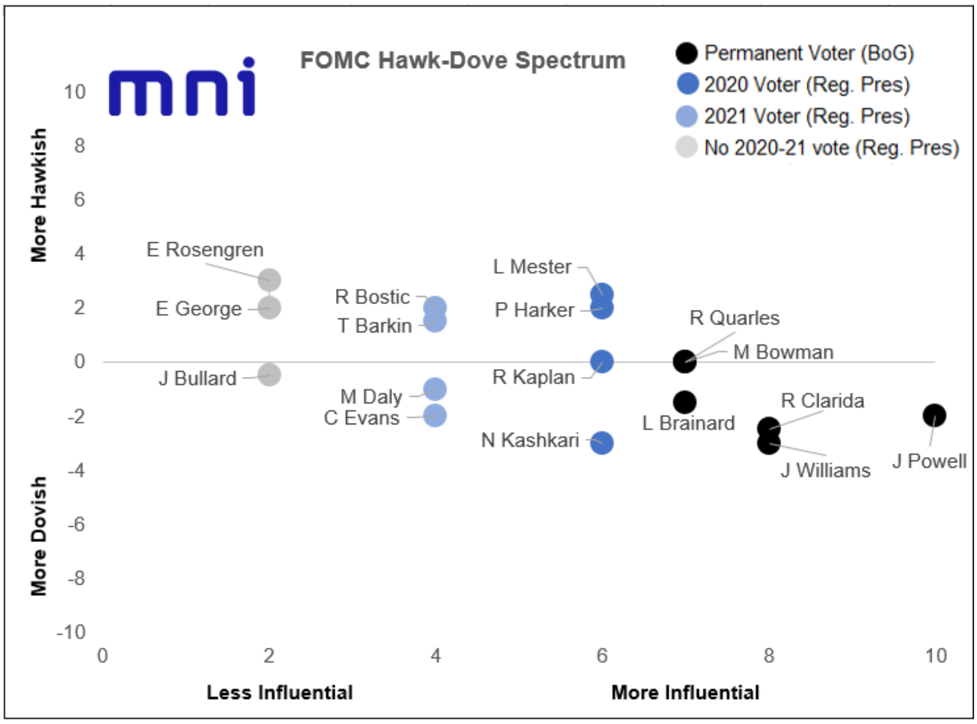
- There have been signs of improved economic activity since the July FOMC, with inflation / inflation expectations also ticking higher from the lows. *(Updated Sep 14)*

Key Inter-Meeting FedSpeak – Sep 2020

Chair Powell let the cat out of the bag at his highly-anticipated Jackson Hole appearance in August, announcing the conclusion of the policy framework review and unveiling the Fed's revised longer-term policy statement. This obviously precluded the unveiling of the new statement at the September FOMC. That being said, communications from many FOMC members since July and indeed since Jackson Hole have pushed back against the near-term adoption of other long-anticipated policy shifts that were once considered to be tied to the completion of the framework review, including stronger forward guidance (probably linked to meeting macroeconomic objectives) and/or a shift in asset purchase policy (buying more Tsys / extending maturity of holdings).

Here are the prevailing FedSpeak themes since the July FOMC:

- Several FOMC members have recently said that they prefer to wait for greater clarity about the economic / virus outlook before pulling the trigger on further easing measures – particularly as market pricing for tightening remains a long way off. This is true for both fwd guidance and asset purchase policy changes, for which several members (Clarida, Brainard, Evans, Williams) suggested consensus remained elusive.
- As Brainard put it, the Fed is currently pivoting "from stabilization to accommodation".
- There remains a general preference to tying a more formal forward guidance policy to macroeconomic outcomes (rather than 'date-based'). In turn, there appears to be a strong preference to tie it to inflation outcomes rather than to employment, though some are eyeing dual-mandate outcomes.
- There appears to be a consensus that "moderate" overshoots of the 2% inflation target would entail readings somewhere between 2-2.5% (eg Kaplan, Bostic, Harker), but the FOMC is likely to emphasize "flexibility" and not being tied down to a particular formula.
- Yield Curve Control does not appear to be a preferred easing option for any FOMC members at this point, but as Clarida and Brainard pointed out, it is part of the toolkit.



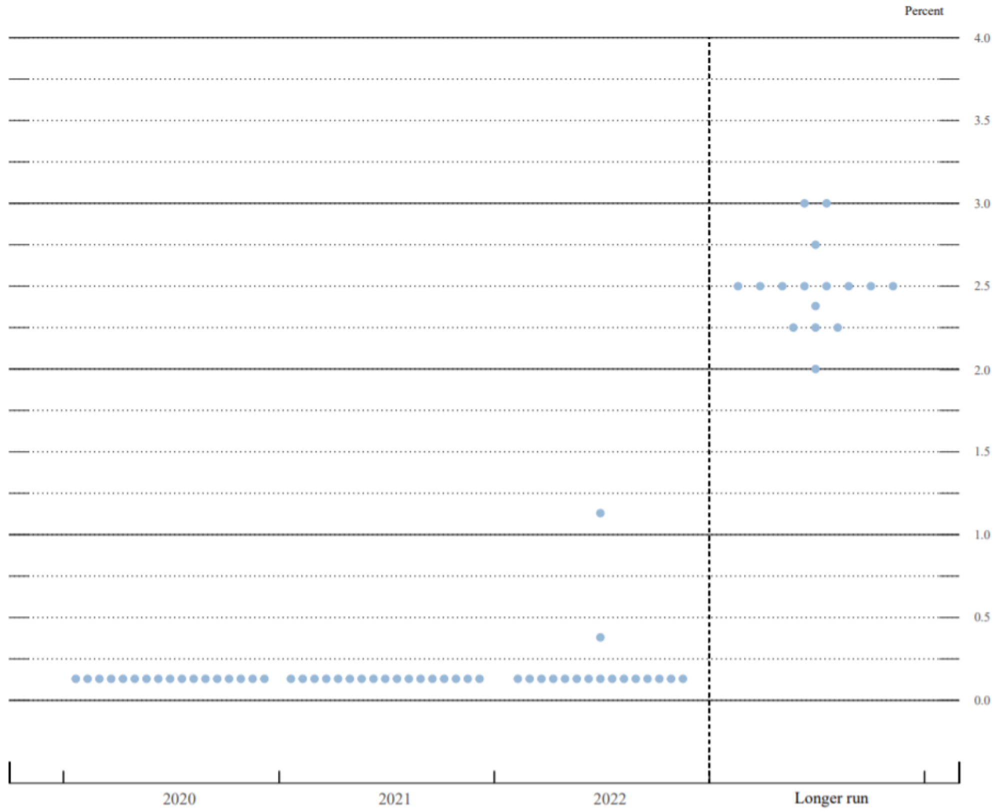
Our matrix uses the following methodology based on the MNI Markets Team`s subjective analysis.* ***Hawkish/Dovish scores*** *indicate MNI`s subjective assessment of each member`s stance on monetary policy. -10 implies member believes aggressive easing warranted; +10 is most hawkish, implies member believes aggressive tightening warranted. Scores around -2 to +2 considered relatively neutral. On ***Influence****, the x-axis runs from 0 ('least influential') to 10 ('most influential'). Voters in the current year receive a minimum score of 6; the Chair receives a 10 and Board of Governors members receive at least 7. Those who are not voters in the current year are limited to a score of 4; among them, those due to vote next year receive higher influence scores (rising towards end of current year), and vice-versa.*

Member	Role	Voter '19	Voter '20	Monetary Policy Commentary Since July FOMC
J Powell	BOG, Chair	X	X	**Re Forward Guidance:** "You can imagine situations where you'd really want to be targeting macroeconomic outcomes. It's also the case, though, that sometimes date-based guidance works too. I think it really is very fact specific, and it's not something we've—we haven't made any decisions on that." – Jul 29 FOMC press conference **Re AIT:** "Our new statement indicates that we will seek to achieve inflation that averages 2% over time. Therefore, following periods when inflation has been running below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time…In seeking to achieve inflation that averages 2% over time, we are not tying ourselves to a particular mathematical formula that defines the average. Thus, our approach could be viewed as a flexible form of average inflation targeting. Our decisions about appropriate monetary policy will continue to reflect a broad array of considerations and will not be dictated by any formula. Of course, if excessive inflationary pressures were to build or inflation expectations were to ratchet above levels consistent with our goal, we would not hesitate to act." – Aug 27 Jackson Hole speech -"Inflation — high inflation — has not been a problem in the United States" – Sep 4, NPR interview **Re Economic Outlook:** "I'd say that the recovery is ongoing. It may be continuing at about the same pace... We do think it will get harder from here... There's going to be a long period, we believe, where we'll have to take our time and see those people get back to work... We seem to be living a case that is a positive case where you actually see economic activity continuing. It continued through the outbreak in the South and the West this summer. And the signs you would think — with the failure to extend the CARES Act — you would think you'd see some slowing. There may be a modest slowing in the pace of improvement, but improvement goes on" – Sep 4, NPR interview
J Williams	NY Fed, V Chair	X	X	**Re Forward Guidance:** "Even the topic of raising interest rates is so far off in the future that I'm not going to focus on that right now." – Sep 2 Bretton Woods event **Re AIT:** "One of the things you'll notice in the framework statement is we really are emphasizing that we're not tied to a particular view of a natural rate of unemployment or a specific number but looking at a broad set of indicators around the labor market and again focused on shortfalls rather than the previous language of deviations." – Sep 2 Bretton Woods event
R Clarida	BOG	X	X	**Re Forward Guidance/Asset Purchases:** "In terms of guidance, I'm obviously not going to comment on any particular meeting, what I would say is that the minutes in our July meeting indicated that we did have discussions at that meeting about potential ways that we might refine our rates guidance and thinking about the balance sheet. Now that we have concluded our review, I would anticipate that we would return to those discussions." -Aug 31 PIIE event **Re AIT/Yield Curve Control/Changes To SEP Format:** "To be clear, "inflation that averages 2 percent over time" represents an ex ante aspiration, not a description of a mechanical reaction function—nor is it a commitment to conduct monetary policy tethered to any particular formula or rule….It will be appropriate to aim for a modest overshoot of inflation, just to demonstrate that that inflation can operate on 2% to both sides of that 2% goal. There's potentially a place for yield curve controls… [yield curve control] is certainly something that's in the toolkit. We're not inclined or thinking about deploying it right now, but it's certainly in the toolkit….Now that we have ratified our new statement, the Committee can assess possible refinements to our SEP with the aim of reaching a decision on any potential changes by the end of this year." -Aug 31 PIIE event
L Brainard	BOG	X	X	**Re Policy Outlook:** "Now that we've concluded the review, I would anticipate we would return to a discussion of appropriate monetary policy. And it is consequential in my mind that the new consensus statement will frame our policy deliberations as monetary policy pivots from stabilization to accommodation. The committee's discussion of policy at the next meeting and beyond will be framed by the goals and strategy that were agreed in the statement." – Sep 1 Brookings event **Re Yield Curve Control:** "It's clear from the minutes of our [July] meeting that yield targeting is certainly in the toolkit and there could be circumstances where it would be considered to reinforce forward guidance akin to what the Reserve Bank of Australia is doing. We're not thinking about deploying it right now but it's certainly in the tool kit." – Sep 1 Brookings event
R Quarles	BOG	X	X	**No monetary policy comments since July FOMC**
M Bowman	BOG	X	X	**No monetary policy comments since July FOMC**
P Harker	Phil Fed		X	**Re AIT:** "Somewhere north of 2% but to me it's not so much the number, whether it's 2.5% or 3%. It's whether it's reaching 2%, creeping up to 2.5%, or shooting past 2.5%, so it's really about the velocity of inflation, not just the overall level. – Aug 28, CNBC interview
R Kaplan	Dall. Fed		X	**Re Fwd Guidance:** "I would far prefer when we do give forward guidance in the future that we tie it to our dual mandate and particularly tie it to unemployment along with making progress on inflation" Aug 3, BBG interview "I would prefer to wait. I would prefer to get more clarity on the path of the virus. I think we've given quite a bit of forward guidance through our SEP, and we'll do another one in September, we've already said rates are going to stay the rest of this year and all of next year, and I would prefer to show some restraint here." – Aug 28, BBG interview **Re AIT:** "For me, a little bit means a little bit… 2.25%, maybe a little bit more than that. I still think price stability is the overriding goal and this framework does not change that." – Aug 28, BBG interview

Member	Role	Voter '19	Voter '20	Monetary Policy Commentary Since July FOMC
N Kashkari	Minn. Fed		**X**	**Re Forward Guidance:** "Market expectations are that rates will be low for a long period of time, and so I don't feel like there's a burning pressure that we need to change our forward guidance today to change market expectations… My guess is that we will adopt some more formal form of state-contingent forward guidance, but the committee just hasn't gotten to that conclusion yet… I think forward guidance that is anchored to an outcome of actually achieving our inflation target would be a big step forward relative to where we are today." – Aug 26 BBG interview
L Mester	Clev. Fed		**X**	**Re Forward Guidance:** "I have some preference for using outcome based [forward guidance] because it's tied to our monetary policy goals, and so I think that's good communication." – Sep. 2 Q&A @ EMS **Re Asset Purchases:** "At some point the transition would be for supporting the recovery and supporting the sustainable recovery. And asset purchases, as you know, are one of the tools for doing that. But I don't think there's any immediate need now to change that." -Sep. 2 WSJ Interview **Re AIT: "**It's important to know that we're going to not let inflation run rampant, but we're also going to make sure that inflation, which is biased down, that we have a mechanism for bringing it back up." – Sep. 2 Q&A @ EMS **Re Framework Review:** "The subcommittee on communications is going to be looking at whether there are enhancements that could be made to the SEP... Whether [we'll] end up labelling the dot plots, that's been considered prior and there's always pros and cons of doing that." - Sep. 2 Q&A @ EMS **Re Economic Outlook**: "There's a lot of uncertainty out there and I do think that the downside risks dominate over the upside risk and so I do think we're going to need to be prepared for this to take long." - Sep. 2 Q&A @ EMS
J Bullard	St. Louis Fed	**X**		**Re Forward Guidance/Asset Purchases:** "Bullard said he does not see a rush to make either longer-term promises about interest rates or to try to amp up the economy through more stimulus efforts. That should wait, he said, until the health risks are more contained and the Fed wants to actively encourage more borrowing, spending, and activity to boost the economy when it is safer for people to fully engage in commerce again. "At least for now expectations are that the Fed will stay where we are for a very long time," Bullard said. "The idea that you want to stimulate things presupposes that the virus has gone away." – Aug 19 Reuters interview **Re AIT:** "The idea would be that we're going to try to make up for past misses but it's going to be in the judgment of the committee and there are different opinions around the table." – Aug 27 BBG Interview "Inflation has run below target certainly by half a % for quite a while so it seems like you could run above for a half a % for quite a while. The idea here is to cement inflation expectations at the 2% target because you really want that credibility all the time." – Aug 28, CNBC Interview
C Evans	Chic. Fed	**X**		**Re Forward Guidance:** "If I had a better idea of where we're going to be next spring, and things like that, I'd know whether or not we need to ramp up extraordinarily accommodative policies like we did during the last recovery…I think we have to know more, and can't make that judgment now." Sep 3, Q&A w reporters "Articulating outcome-based forward guidance for the rate path and asset purchases could be beneficial in the not-too-distant future," -Sep 3
E George	K.C. Fed	**X**		**Re Forward Guidance/Asset Purchases:** "holding rates where they are today is really going to be a function of how the economy unfolds. And I think right now, it's too soon to really tell what's going to happen—what will happen this fall in terms of the virus, what will happen in terms of the pattern of recovery…I have talked about the role of asset purchases, low-for-long interest rate policy, and the implications that can have for financial stability, for creating imbalances. So that is always a concern, and I suspect will be something we are going to have to focus on in the years ahead" – Aug 25, Yahoo interview
E Rosengren	Bos. Fed	**X**		**Re AIT:** "I'm still actually concerned we are going to have difficulty reaching our 2% inflation target… Some things have been a little scarce as a result of the pandemic, other things have been in abundant supply... I think there will be relative price changes that makes the reported numbers seem larger. Right now, with 10% unemployment, I'm not concerned about inflation growing at a rapid rate." – Aug 12, BBG interview
T Barkin	Rich. Fed			**Re Forward Guidance:** "As the chair said recently, we're not even thinking about thinking about raising rates right now. Markets understand this and seem to have taken our forward guidance to heart." – Aug 19, NEC webinar **Re AIT:** "I agree with some version of, 'It is judgment not a formula or a rule.' It's circumstantial. It depends on where you are. And that it's moderate. I'm reasonably OK with the ranges that have been listed." -Sep 2, WSJ interview
R Bostic	Atl. Fed			**Re Forward Guidance:** "Right now I don't think there's a lot of uncertainty about the Fed's commitment to supporting the economy and supporting the recovery so that we get to something that looks like a much more natural progression of the economy…As we get to that period when it's clear to everyone that we are transitioning out of an emergency setting into a more stable setting, that's when I think the kind of forward guidance and clarity you are talking about will become more important..I don't think we are there right now." – Sep 3, WSJ interview **Re AIT:** "I am comfortable with the inflation rate going over 2%—2.2%, 2.3%, 2.4%. That doesn't concern me that much. What I focus on, or will focus on much more, is the trajectory. So if we're at 2.4% and it stays at 2.4% for a year and a half, that's stable prices. That is meeting the mandate that we have. But if we're at 2.4%, and then we go to 2.7%, and then it starts looking at 2.8% or 2.9%, that's the type of thing that will trigger a concern."
M Daly	S.F. Fed			**Re Forward Guidance:** "Right now I think it's pretty clear [rates will remain at the zero lower bound] and so you don't need to have that additional bit, but there will probably come a time when that additional clarity is required and I'm very supportive of that, I think the research has shown that's very effective." – Aug 12 - "We can always do more forward guidance of course, and we can do additional quantitative easing," Daly told reporters, adding she doesn't see any "misalignment" with the market…"We see a yield curve that's pretty flat" .. Markets are "pretty much understanding what we are doing."" – Sep 3, as reported by MNI

Previous Dot Plot/SEP (June FOMC)

Economic Projections / Dot Plot FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate. Source: Federal Reserve



Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy. Source: Federal Reserve

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2020	2021	2022	Longer run	2020	2021	2022	Longer run	2020	2021	2022	Longer run
Change in real GDP	-6.5	5.0	3.5	1.8	-7.6–-5.5	4.5–6.0	3.0–4.5	1.7–2.0	-10.0–-4.2	-1.0–7.0	2.0–6.0	1.6–2.2
December projection	2.0	1.9	1.8	1.9	2.0–2.2	1.8–2.0	1.8–2.0	1.8–2.0	1.8–2.3	1.7–2.2	1.5–2.2	1.7–2.2
Unemployment rate	9.3	6.5	5.5	4.1	9.0–10.0	5.9–7.5	4.8–6.1	4.0–4.3	7.0–14.0	4.5–12.0	4.0–8.0	3.5–4.7
December projection	3.5	3.6	3.7	4.1	3.5–3.7	3.5–3.9	3.5–4.0	3.9–4.3	3.3–3.8	3.3–4.0	3.3–4.1	3.5–4.5
PCE inflation	0.8	1.6	1.7	2.0	0.6–1.0	1.4–1.7	1.6–1.8	2.0	0.5–1.2	1.1–2.0	1.4–2.2	2.0
December projection	1.9	2.0	2.0	2.0	1.8–1.9	2.0–2.1	2.0–2.2	2.0	1.7–2.1	1.8–2.3	1.8–2.2	2.0
Core PCE inflation[4]	1.0	1.5	1.7		0.9–1.1	1.4–1.7	1.6–1.8		0.7–1.3	1.2–2.0	1.2–2.2	
December projection	1.9	2.0	2.0		1.9–2.0	2.0–2.1	2.0–2.2		1.7–2.1	1.8–2.3	1.8–2.2	
Memo: Projected appropriate policy path												
Federal funds rate	0.1	0.1	0.1	2.5	0.1	0.1	0.1	2.3–2.5	0.1	0.1	0.1–1.1	2.0–3.0
December projection	1.6	1.9	2.1	2.5	1.6–1.9	1.6–2.1	1.9–2.6	2.4–2.8	1.6–1.9	1.6–2.4	1.6–2.9	2.0–3.3

In the revised Statement on Longer-Run Goals and Monetary Policy Strategy shown below, **underlined bold red** text shows additions and ~~struck through~~ text shows deletions relative to the statement the Committee issued on January 29, 2019. Note that the discussion of the employment and inflation goals has been separated into two paragraphs and their order reversed relative to the January 2019 statement. To improve readability, these changes are not marked with underlined bold red text or struck-through text.

Statement on Longer-Run Goals and Monetary Policy Strategy

Adopted effective January 24, 2012; as amended effective ~~January 29, 2019~~ **August 27, 2020**

1. The Federal Open Market Committee (FOMC) is firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment, stable prices, and moderate long-term interest rates. The Committee seeks to explain its monetary policy decisions to the public as clearly as possible. Such clarity facilitates well-informed decisionmaking by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society.

2. **Employment,** inflation, ~~employment,~~ and long-term interest rates fluctuate over time in response to economic and financial disturbances. **Monetary policy plays an important role in stabilizing the economy in response to these disturbances. The Committee's primary means of adjusting the stance of monetary policy is through changes in the target range for the federal funds rate. The Committee judges that the level of the federal funds rate consistent with maximum employment and price stability over the longer run has declined relative to its historical average. Therefore, the federal funds rate is likely to be constrained by its effective lower bound more frequently than in the past. Owing in part to the proximity of interest rates to the effective lower bound, the Committee judges that downward risks to employment and inflation have increased. The Committee is prepared to use its full range of tools to achieve its maximum employment and price stability goals.** ~~Moreover, monetary policy actions tend to influence economic activity and prices with a lag. Therefore, the Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals.~~

3. The maximum level of employment is **a broad-based and inclusive goal that is not directly measurable and changes over time owing** largely ~~determined by~~ **to** nonmonetary factors that affect the structure and dynamics of the labor market. ~~These factors may change over time and may not be directly measurable.~~ Consequently, it would not be appropriate to specify a fixed goal for employment; rather, the Committee's policy decisions must be informed by assessments of the **shortfalls of employment from its** maximum level ~~of employment~~, recognizing that such assessments are necessarily uncertain and subject to revision. The Committee considers a wide range of indicators in making these assessments. ~~Information about Committee participants' estimates of the longer-run normal rates of output growth and unemployment is published four times per year in the FOMC's Summary of Economic Projections. For example, in the most recent projections, the median of FOMC participants' estimates of the longer-run normal rate of unemployment was 4.4 percent.~~

4. The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee reaffirms its judgment that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate. The Committee ~~would be concerned if inflation were running persistently above or below this objective. Communicating this symmetric inflation goal clearly to the public helps keep~~ **judges that** longer-term inflation expectations ~~firmly~~ **that are well** anchored~~, thereby~~ **at 2 percent** foster~~ing~~ price stability and moderate long-term interest rates and ~~enhancing~~ **enhance** the Committee's ability to promote maximum employment in the face of significant economic disturbances. **In order to anchor longer-term inflation expectations at this level, the Committee seeks to achieve inflation that averages**

2 percent over time, and therefore judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time.

5. **Monetary policy actions tend to influence economic activity, employment, and prices with a lag.** In setting monetary policy, the Committee seeks **over time** to mitigate **shortfalls of employment from the Committee's assessment of its maximum level and** deviations of inflation from its longer-run goal ~~and deviations of employment from the Committee's assessments of its maximum level~~. **Moreover, sustainably achieving maximum employment and price stability depends on a stable financial system. Therefore, the Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals.**

6. ~~These~~ **The Committee's employment and inflation** objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it ~~follows a balanced approach in promoting them, taking~~ **takes** into account the ~~magnitude of the~~ **employment shortfalls and inflation** deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate.

7. The Committee intends to ~~reaffirm~~ **review** these principles and to make adjustments as appropriate at its annual organizational meeting each January**, and to undertake roughly every five years a thorough public review of its monetary policy strategy, tools, and communication practices**.

Analysts' Key Comments

Note summaries in alphabetical order of institution. All analysts expect no change in the Funds rate at the September FOMC, but opinion varies on changes to other policy tools. Key abbreviations: Fwd Guidance = Forward Guidance; SEP = Summary of Economic Projections; YCC = Yield Curve Control; AIT = Average Inflation Targeting

ANZ: Fed Boldly Goes After Employment To Seek Inflation

- Despite new long-run objectives, FOMC won't make any major announcements on fwd guidance or asset purchases this week. But will be some language tweaks to reflect the updated framework, incl on its objective, "to achieve inflation that averages 2% over time".
- FOMC may also shift to acknowledge asset purchases about supporting macroeconomic objectives rather than just market functioning.
- The Fed will detail, in coming months, its expected path for rates and asset purchases.
- **Statement:** To recognize better-than-expected economic activity since July FOMC. But given weaker fiscal outlook now, Fed likely to be concerned that econ could face stiff headwinds.
- **SEP/Dot Plot:** Dot plot to remain flat, signalling rates at zero until at least the end of 2023.
- SEP to drop the forecast of the longer-run unemp rate given it is no longer relying on it to assess shortfall.
- **Press Conference:** Powell to be concerned about fiscal outlook beyond Q320. May face questions on the Fed's tolerance for inflation overshoot and the time period over which 2% infl to average.
- Also expected to be asked how and when FOMC expects to introduce stronger fwd guidance and to clarify the medium-term outlook for asset purchases.

Barclays: From Stabilization To Accommodation

- This meeting is a good opportunity for the Fed to signal its intentions about asset purchases, namely saying that ongoing asset purchases will support the recovery by putting downward pressure on longer-term interest rates and keeping financial conditions accommodative.
- Fed to modestly lengthen the average duration of Tsy purchases, which would better complement fwd guidance, with the former reducing longer-dated term premiums and the latter pinning down expected policy rates at the front-end.
- We no longer expect the Fed to alter its policy rate guidance in September. Though warranted, FOMC members appear to be awaiting greater clarity on the outlook.
- **SEP/Dot Plot:** Near-term econ outlook upgraded, median dot at zero through end-2023.
- **Press Conference:** Powell to emphasize that downside risks to the outlook from COVID-19 and fiscal policy uncertainty remain.

BofAML: A Risk That The Market Is Underwhelmed

- Fed to take the first step in shifting from stabilization to accommodative policies via stronger fwd guidance, linking departure from the ZLB to an inflation overshoot. Will also tie balance sheet policy to supporting the economy rather than market stabilization.
- May also indicate they intend to continue asset purchases "at least" through the middle of 2021, as is generally expected by the market. But unlikely to strongly signal a near-term need to increase pace of Tsy buying or "twist" in the distribution of purchase at present.
- The rates market will be most focused on changes to fwd guidance and any balance sheet adjustments. A risk the market is underwhelmed by the guidance provided by the Fed, which would support higher back-end rates and a steeper curve.
- **Statement:** To reflect AIT in framework change, e.g. "prepared to allow inflation to run moderately above this level to average 2% over time." And on balance sheet, as above.
- **SEP/Dot Plot:** To show rates on hold through 2023; all participants on hold through 2021, a couple are likely to pencil in hikes in 2022, and a few in 2023. Near-term econ projections likely to be revised to reflect

stronger data, but beyond 2020, few changes (incl to long-run projections), with core infl forecast below 2% through 2023.
- **Press Conference:** Powell should address the toolkit and perhaps offer some guidance about the triggers to using these additional tools. Will likely be asked to provide clarity on what it means to "moderately" overshoot 2% inflation and to explain "some time".
- Powell is unlikely to give specifics since they are intentionally looking for the AIT to be flexible and avoid the impression of a mechanical rule, but he may offer some general markers for the Fed to be convinced of an inflation overshoot, which could include evidence of an active Phillips Curve with wage pressure building and inflation expectations increasing along with core PCE inflation running above 2%.
- He will likely continue to urge greater fiscal stimulus and make it clear the Fed can't act alone. May discuss the possibility of forthcoming changes to the SEP and how to interpret the forecasts from the Fed.

BMO: Rates Low For Longer (To 2024 At Least)

- The forward guidance currently being employed in the policy statement doesn't have to be altered much.
- It's looking like rate hikes are going to be a 2024 story, at the earliest.
- **SEP/Dot Plot:** While the 2020 unemployment projection should fall, the remaining years should still sit noticeably above the longer-run level (likely to remain at 4.1% but with downside risk). For core PCE, 2020 could rise a bit, but remaining years at/below 2%.
- No hikes on horizon, with most participants (at least 9) concurring on 2023 at lower bound.

BNP Paribas: To Deliver Outcome-Based Forward Guidance

- Fed to deliver enhanced, outcome-based fwd guidance and clarification on asset purchases (as QE rather than market functioning, though will keep composition/size/pace of buys unchanged).
- To not provide new fwd guidance at this meeting would risk public perception of a piecemeal approach.
- Modified parameters to fwd guidance to cover both employment and inflation. The 2012 Evans Rule could serve as a rough template for something similar this time, but with greater emphasis on employment. So unemp threshold could be around 4.5%, and core PCE a necessary but not sufficient on its own condition for the FOMC to consider lift-off.
- But a risk they will deliberate but not deliver, in which case it will still act on the above, but likely in Dec. The Nov meeting is too close to the election.
- While the Fed to continue considering YCC and size/duration changes to balance sheet as possible tools, ultimately fiscal policy will have more impact on the economic recovery.
- **Statement:** Must reflect the change to flexible AIT strategy. Remove reference to legacy symmetric 2% inflation goal, now to emphasize that in order to better anchor expectations at 2%, will target inflation over the cycle, making up for downside misses by setting policy to aim for “moderate” above-target misses “for some time” but retaining flexibility on responding to upside misses.
- **SEP/Dot Plot:** Mark up of 2020 growth, employment, and inflation expectations, but hold steady in its 2021-22 forecasts, implying a slower rate of progress. Median projections will have rates at zero through 2023 but will not have unemp at longer-run estimate or inflation at target by then.

CIBC: Could Shift From Calendar-Based To Economic Condition-Based Guidance

- Nothing announced on QE or rates.
- At some point (perhaps this meeting), guidance to shift from calendar-based approach in ‘dot plot’ to the to the kind of economic conditionality the Bank of Canada is now using, in the Fed's case tied to labour market conditions as well as inflation.
- **SEP/Dot Plot:** To acknowledge the faster-than-expected economic rebound, but might not materially alter projections for the timing of full recovery.

Citi: Focus On Future Action, Not Taking Action Now

- With a focus at this meeting on future action, the minutes, and to a lesser extent the press conference, may be more interesting than the post meeting statement.

- Won't formally adopt fwd guidance (ie no hike until infl at/exceeds 2% for some time), but will discuss at this meeting – officials prefer to take more time to deliberate. So Dec the earliest to see change.
- Could recharacterize asset purchases as econ support rather than market functioning, but not a mkt mover.
- FOMC likely to discuss some combo of increasing Tsy buy pace and lengthening duration, but no change at this meeting from $80bln/mo. MBS buys are likely faster than what FOMC officials will be comfortable with longer-term, but tapering likely an item for Dec or later.
- **SEP/Dot Plot:** 2020: growth revised higher, unemp lower; core PCE closer to but still below 2%. But in 2021, infl unch at ~2%, unemp above full employment = dovish stance eyeing addition rather than removal of accommodation (most dots at zero into 2023, long-run median unch at 2.5%).

Commerzbank: Step Back And Wait To See How Things Play Out

- While the FOMC could somewhat adjust the statement to bring it in line with the new strategy, don't expect further details – for example, on the upper tolerance limit for inflation.
- After the announcement of the new strategy, Fed to prefer to step back and see how things play out; to hold rates and maintain the pace of bond purchases. The Fed now sees fiscal policy doing the heavy lifting.
- **SEP/Dot Plot:** Fate of the SEP/'dot plot' as a communications tool remains unanswered following framework review. Could revise 2020 GDP forecast up; also unemployment rate projections down.
- Dots to reflect expectations of unchanged rates for next few years.

Credit Suisse: SEP To Show Inflation Overshoot

- No urgency for the Fed to refine fwd guidance at this meeting.
- FOMC may choose to clarify that asset purchases are now conducted to provide policy accommodation, on top of supporting market functioning.
- The next policy innovation would be outcome-based forward guidance, possibly at the Dec FOMC.
- YCC another option, but many officials are skeptical and this would likely only be implemented if economic and financial conditions deteriorate.
- **Statement:** To reflect further pick-up in econ activity, while still well below pre-COVID levels.
- **SEP/Dot Plot:** No hikes in median dot through 2023, but some participants may see a need for hikes by then. Upward revisions for near-term growth, unemp, inflation. Inflation projections showing overshoot of 2% in core PCE further out.
- **Press Conference:** Powell to sound cautious tone on the outlook, to discuss framework change and emphasize both AIT and new unemployment gap concept. Will stress need for more fiscal policy support.

Danske: FOMC To Take Action Amid Subdued Inflation Expectations

- Fed to change fwd guidance by stating that 'the Committee expects to maintain this target range until it is confident that inflation will run above 2% for some time' and to increase QE buying.
- The FOMC will recognise the importance of building up credibility right away, especially as inflation expectations remain subdued.

Deutsche: No Action At This Meeting, But It's A Close Call

- While better-than-expected data since July could reduce the urgency for more accommodation, the failure to reach another fiscal deal as well as a modest tightening of financial conditions, have strengthened the case for more accommodation.
- A refresh of the FOMC's language that better reinforces their new policy framework makes sense at upcoming meetings, but recent communications ('at some point' in July minutes etc) suggest that this week is likely too early. Dot Plot can help reinforce expectations even without changes to language.
- While the Committee on balance seems to side with outcome-based forward guidance, it may take more time to reach a consensus on any material changes.
- If language is revised at this meeting, it would likely only be a modest change to replace "on track" with "near" or "close to". Stronger forms incl specific quantitative thresholds are the destination, but not yet.
- Fed to adjust communications around asset purchases, emphasizing the role in easing financial conditions.

- But will maintain current pace / composition of asset purchases at this meeting. FOMC may want to save this 'bullet' before further fine-tuning the degree of accommodation.
- **SEP/Dot Plot:** Upgrade to near-term growth, inflation, employment; but both infl and unemp unlikely to approach longer-run goals until 2023. But will reflect an overshoot for both infl and empl in 2023 without an accompanying policy response, thereby cementing commitment to new flexible AIT.
- Structural changes to SEP unlikely at this meeting (Clarida suggested around year-end).
- **Press Conference:** 3 main issues: how FOMC sees evolving econ outlook, esp re fiscal (Powell to refrain from specific prescriptions but could note need for more); further clarification on longer-run statement (Powell not expected to provide additional clarity on parameters around flexible AIT apart from "moderate" overshoot); discussions on fwd guidance/asset purchases.
- Powell could also be asked about recent market volatility and implications of 2020 election.

Goldman Sachs: Next Hike In…2025

- Statement to recognize the new AIT approach by replacing the current reference to its "symmetric 2 percent inflation objective" with a reference to "inflation that averages 2% over time."
- No changes to fwd guidance / QE because several on FOMC have said they see little urgency/want greater clarity on outlook. Such changes most likely in November.
- Fwd guidance to be one that delays liftoff until the economy achieves both full employment and 2% inflation (perhaps for a year), although stricter inflation criterion is possible too.
- On that basis, Fed to hike rates next in 2025.
- Fed to also transition to a more traditional asset purchase program that tilts purchases toward longer maturities as the goal shifts to providing accommodation and supporting the recovery.
- **SEP/Dot Plot:** Large upgrades to growth/unemp forecasts. But even at end of 2023, median unemp rate to be higher than longer-run rate and inflation just below 2%.
- Three participants to show hikes by 2023.

HSBC: Longer-Run Funds Rate Projection Could Be Reduced

- **Statement:** FOMC to refine fwd guidance, drawing heavily on the themes of its new framework document. However, we are unconvinced about whether changes will include a specific date-based or outcome-based commitment to keep the federal funds target range at its current 0-0.25% setting.
- Although we expect the FOMC to recast how it describes the goals of its asset purchases in September, we do not think that the actual volume of purchases will be changed.
- **SEP/Dot Plot**: Median funds rate projection at zero through 2023, reinforcing HSBC's view that rates will remain steady at least through 2021.
- Median projection for the longer run rate will remain at 2.5% in September. But given the Committee's unanimous approval of the new framework statement in August, it is quite possible that some of the participants will choose to reduce their projections.
- **Press Conference:** Powell to use new projections to highlight the FOMC's views.
- Market participants likely to pay close attention for any clues about the likely trajectory of asset purchases in 2021 and beyond. Powell likely to emphasize that the FOMC's commitment to a highly accommodative monetary policy will extend to its future decisions on asset purchases, but he may acknowledge that the current pace of QE is unlikely to be sustained on a permanent basis once an economic recovery has been underway for a longer period of time and some of the uncertainties that surround the outlook have diminished.

ING: Lower For Even Longer

- Unlikely to be any policy change at this meeting, but a change in the statement given Fed's shift in thinking, and a clear message from the presser that rates will remain lower for longer.
- We are shifting to the view that we are quite a way off before the Fed needs to step in with more forceful language on the timing of rate hikes.
- Little need at current juncture to introduce stronger fwd guidance given rate expectations are on the floor for the next few years and dot plot is signalling nothing before 2023.

- **SEP/Dot Plot:** Likely to see growth expectations higher/unemp lower, but not much change in inflation projections or rate dots (no-one to join the previous 2 of 16 members seeing a hike by end-2022).
- We tentatively suggest there is a consensus behind one rate hike before the beginning of 2024, but this is not a strong conviction call. We also wouldn't be surprised to see the long run expectation for the Fed funds rate revised lower given the new thinking within the Fed.
- **Press Conference:** Powell to reinforce message of no interest in raising rates in next couple of years, which should anchor short-end even more sturdily. To leave door open to further potential action, most likely involving additional QE.

JPMorgan: Not Clear The Market Believes The Fed's New Inflation Strategy

- While a move to inflation outcome-based forward guidance is "the right thing to do", recent Fed-speak has led JPM to dial back expectations for the Sep FOMC. More likely that current vague fwd guidance remains unchanged, though a close call.
- It's not clear the market believes the new inflation strategy, with some measures of inflation expectations below the Fed's objectives, and unchanged since the shift to flexible average infl targeting.
- No change to size or composition of asset purchases, reiterate buys to continue "over the coming months". However the statement may adjust the rationale for these purchases to one of supporting a stronger economic recovery, rather than supporting the flow of credit.
- **Statement:** To take note of econ activity pickup/employment but highlight that both remain well below levels at the beginning of the year, and that COVID poses 'considerable risks' to the outlook.
- **SEP/Dot Plot:** Median dot to show no hike through end-2023. 4/5 could see 2023 liftoff.
- Unemp rate projections revised lower – could lead 2023 unemp close to natural rate, in turn meaning core PCE forecast 0.1-0.2 above 2% (on that note, the SEP could stop including a natural rate estimate, but that's probably a change for the December FOMC). 2020 GDP higher, lower for 2021.
- No major changes to the 'star variables' (ie neutral rate of interest etc).

Lloyds: Looking For More Details On AIT

- No new policy stimulus expected this week.
- Markets will be on the lookout for more details on the new inflation-targeting regime.

Morgan Stanley: This Time Is Different

- We now see a higher probability of the Fed achieving its 2% average inflation goal in this business cycle – an outcome that's underappreciated.
- The FOMC will eventually settle on an outcome-based forward guidance formulation that better expresses how policy will operate in the current cycle and under the new inflation framework, but while there is much to change in the FOMC policy statement at the upcoming September FOMC meeting in order to reflect the new inflation framework, comments from Fed policymakers in recent weeks have indicated little rush at this point to provide explicit outcome-based guidance linked to economic thresholds.
- Fed likely to guide at some point (though may fall short at Sep FOMC) that under the new framework, policy should remain accommodative at least until inflation sustainably reaches 2% in the context of a broad labor market recovery that is consistent with the FOMC's maximum employment goal.
- Extending the duration of the Fed's Treasury purchases is a policy decision we do not expect near term, but remains firmly in play, if not likely,as the recovery progresses. The Fed will choose not to use YCC, but will instead continue to specify a quantity and composition of asset purchases.
- Conditions will be in place for the Fed to raise rates by 1H 2024, if not sooner, with balance sheet tapering to start around mid-2022, and end of asset purchases in early 2023 (1 year ahead of rate hikes beginning).
- Later this year, FOMC to indicate that 1) fwd guidance and asset purchases remain core tools at ZLB; 2) negative rates lack an attractive cost-benefit today; 3) YCC requires more study but it's on the table.
- A guiding principle for the Fed's review of its tools seems to be that it is unwise to categorically remove a potential tool from the toolkit as conditions may change and a time may be presented when those tools are needed. Remaining ambiguous about the potential for interest rates to go negative can also have benefits through its influence on longer-term interest rates.
- Later this year, SEP to be modified to better reflect uncertainty and the FOMC reaction function.

NatWest: More QE At This Stage Would Not Produce Much Bang For The Buck

- Change to fwd guidance possible but unlikely, FOMC not ready to take that step.
- Possible they choose to alter language around asset purchases from market functioning to providing/maintaining accommodation, but even if they do, the near-term practical implications might be minimal as they are not expected to alter the actual program at this time – it's merely mark-to-reality.
- FOMC seems to favour explicit fwd guidance as the next easing lever, not asset purchase changes.
- The implication of the move to flexible AIT for asset purchases is more likely to be a longer lasting program than an upcoming escalation in scale. But that in itself is not a market-mover, and in any case the Fed may not get much bang for their buck on further asset purchases. Another 25bps drop in the range for 10-year yields isn't going to get people back in gyms, movie theaters, or planes.
- QE status quo to remain unless we see a significant "bad" (ie supply driven) increase in long-end yields.
- **Statement:** Probably will not change the assessment of current conditions. But if any changes, likely to lean dovish. Possibly re-insert a line on inflation expectations.
- For "In determining the timing and size of future adjustments to the stance of monetary policy" language, could weave in results of long-run strategy change. Mester recently said: "It's important that the statement that comes out of the FOMC meeting be consistent with the new strategy document".
- **SEP/Dot Plot:** To reinforce that zero-rate stance appropriate through 2023.
- Upgrade to 2020 outlook, but do not expect infl projections much above 2% (if at all -i.e., no overshoot forecast) and no rate hikes in forecast. Longer-run Fed funds dot may edge lower, with the median level falling from 2.500% to 2.438%.
- **Press Conference:** Powell to sound cautious about the outlook. Will spend a lot of time recapping the Jackson Hole announcement, emphasizing that rates are unlikely to be raised for along time.

Nomura: A Time For Deliberation

- No major policy innovations at this meeting; recent comments from FOMC members suggest consensus for stronger, outcome-based fwd guidance/significant changes to asset purchases remains some ways off.
- The FOMC to adopt outcome-based fwd guidance by the end of the year. FOMC to acknowledge more directly than it has previously that its asset purchases are designed to advance its macroeconomic objectives but do not expect major changes at this meeting to the Fed's asset purchases
- FOMC to indicate that it is going to start to wind down offerings of repo operations. With the significant expansion of the Fed's balance sheet since March, demand for these transactions has fallen to very low levels. In coming months, Fed to transition to operating procedures that are consistent with a balance sheet that is likely to remain large for several years - a decline in the offerings of repo transactions will be part of that transition.
- **SEP/Dot Plot:** Do not expect a majority to submit above-2% inflation forecast for 2023, though some risk that the median exceeds 2% "moderately". Longer-run projection for unemployment rate to be dropped from the table.
- **Press Conference:** In general, Powell to reiterate remarks from Jackson Hole. He may also face questions on what type of magnitude and for how long the Committee is willing to tolerate inflation above 2% (the updated LRS only suggests "for some time"). He may also face questions on how and when the Committee expects to introduce stronger fwd guidance and clarify the medium-term outlook for asset purchases.

Nordea: Three Big Unanswered Questions

- Much of the excitement about this meeting has been "ruined" after the Jackson Hole announcement of AIT, but the meeting could turn out to be more interesting than what many market participants might believe.
- The main reason is that the new strategy regime is so vaguely formulated that the pile of unanswered questions has not become smaller. AIT is, in its current form, a much softer regime compared to its sister regime of price level targeting or nominal GDP targeting.
- Of all unanswered questions, three biggest are: 1. How much inflation overshooting is the Fed willing to tolerate? 2. What will the Fed do to accelerate inflation? 3. Will forward guidance be formally changed?
- On 1) could be 2.3% (per SF Fed paper), or 2.25-2.375% (Dallas' Kaplan), or no de facto target at all.
- On 2), inflation swaps have rallied since mid-Jul, but 5y5y should be 2.3-2.4% minimum for credibility.
- By re-increasing QE purchases now, the Fed would ease financial conditions even more and let us know that they mean serious AIT business. Hiking the QE purchase tempo would also have the positive side

effect of easing recent upwards pressure on secured overnight funding rates. Maybe buy more TIPS, or "twist" by buying more long-end securities. (Or eventually, move to "true" helicopter money.)
- On 3), while fwd guidance will be linked to inflation at some point, just before the blackout period several Fed members (Kaplan, Kashkari, Bostic, Mester and Rosengren) downplayed the chances of updated explicit forward guidance (i.e. policy actions linked to time- or objective-based metrics). Again, it seems like the Fed members really do not want to tie their hands and introduce any rules at this point.
- **SEP/Dot Plot:** No hikes in dots through 2023. If 2022-23 PCE inflation at 2.3-2.4%, would be a clear indication of how much "overshoot" Fed is willing to tolerate.

Rabobank: More Dovish Reaction Function Only Relevant Later

- The framework review will lead to a more dovish reaction function in the long run, but hardly seems relevant in the next few years.
- Given adoption of AIT, fwd guidance related to inflation would seem logical choice. Given that markets do not expect the Fed to tighten monetary policy anytime soon, the FOMC may not be in a hurry to provide specific numbers/dates. It would become more urgent once we get closer to the exit from current policies.
- A significant setback in the economic recovery would force the Fed to rethink its monetary policy stance. This could even force the Fed beyond forward guidance. Given the Fed's aversion to negative rates, the next logical step would be yield curve control.
- **SEP/Dot Plot:** Will be interesting to see if FOMC participants expect FAIT to push up inflation to target earlier than they anticipated in June. Or were those projections already based on the introduction of FAIT?

RBC: No Upside For FOMC To Be Anything But Cautious

- Given significant update at Jackson Hole, this meeting should garner much less fanfare than usual.
- FOMC message to remain cautious despite improvement in economic backdrop – no upside to be positive at this juncture and lots of downside.
- **Press Conference:** Good portion to focus on framework changes, incl 1) more willingness to let inflation run above 2% (the inflation averaging provisions) and 2) letting the unemployment rate drift well below the natural rate in the future (the de-linking of employment and inflation that Powell promoted).

Scotiabank: Strengthened Forward Guidance Not Expected Until Later this Year

- No major policy changes.
- **Statement**: May codify reference to AIT. Description of current conditions probably similar.
- **SEP/Dot Plot:** Median to show no hikes by 2023 but the dispersion may widen.
- **Press Conference:** May reveal further discussion of the strategy review but matters such as strengthened forward guidance are not expected to be offered until late in year.

SEB: Shifting To Outcome-Based Forward Guidance Does Not Seem Imminent

- The new AIT policy will not trigger any policy changes. Shifting to outcome-based fwd guidance does not seem to be imminent; will be same messaging on asset purchases at this meeting.
- Fed will eventually have to give clearer guidance on asset purchases. We believe they stand ready to increase the size or shifting to longer maturities. Low yields suggest the Fed is in no rush, however. We expect bond holdings to rise to a little below 7tn or around 1/3 of GDP, by year-end.
- Instead, the Fed will allow its projections to speak for themselves.
- **SEP/Dot Plot:** Rates at zero through 2023 despite improving outlook for employment, and inflation back to the long-term 2% target.

Societe Generale: Follow Up On Framework Changes

- Following Jackson Hole, the FOMC should alter its communication to be in line with an inflation average of 2% over time and a broader assessment on employment.
- Do not expect quantitative approaches to be taken in achieving or timing these targets.

- **SEP/Dot Plot:** Most likely the median Fed funds dot remains unchanged through 2023, but more participant dots and the dot plot should show an increased number of Fed officials seeing a hike.

Swedbank: Eyeing "Overshooting"

- This meeting will nor result in any policy changes but statement will likely include reference to new targets.
- Some Fed members have in the past emphasized that the FOMC in coming months should provide more clarity on the asset purchases and the likely rate path (fwd guidance). At this meeting and during the autumn we will particularly be looking for possible changes in wording to the QE plan.
- Fwd guidance when adopted will be tied to inflation, but evident that FOMC will keep some flexibility as the new goal does not define "moderate" and "average period".
- Moderately overshooting currently lies closer to Dallas Kaplan's upper rather than lower estimate of his interval (2.25-2.5%). Discussions on how large the tolerance for overshooting can be and what the Fed will do to support higher inflation will be of interest in the statement and at the press conference.
- **SEP/Dot Plot:** Small upward revision of econ projections for 2020. Median dots unch through end-2023. Would be reasonable to further reduce NAIRU.

TD: Dovish; Dovish Enough?

- Fed to strike a dovish tone, but no specific inflation-outcome-based fwd guidance now – FOMC wants more time before getting specific on inflation objectives. A minimum "threshold" before tightening is likely.
- That raises the potential for market disappointment, but many dovish aspects to offset: AIT in the fwd guidance on the funds rate (without specificity - rise "moderately above 2% for some time"), wording on QE changed, FOMC seeing through positive economic news, extension of dot plot, Powell presser.
- On QE Wording: putting more emphasis on providing monetary stimulus broadly (vs market functioning) would enable officials to signal that the QE program will be conditioned upon progress on raising inflation and lowering unemployment.
- The QE program will also be tweaked at some point to make purchases more concentrated in longer-term securities but the Fed to retain flexibility next week, with the NY Fed schedule of purchases continuing to determine composition over a two-week period.
- **Statement:** To continue to emphasize net economic weakening, even with recent strength.
- **SEP/Dot Plot:** Almost no hikes in dots through at least the end of 2023, econ projections (median unemp above longer-run through end-23, 2020 GDP upgrade offset by 2021 downgrade, PCE no more than ~2% end-23) to suggest no hikes until well after end-23.
- **Press Conference:** Cautious tone. Keen to see how Powell talks about the potential for a vaccine to accelerate the recovery; on fiscal battle; potential changes to composition of QE purchases and possible conditioning of ending purchases on mandate objectives being met.
- Powell to suggest that fwd guidance will be tweaked again after communications part of their review complete—as distinct from the strategy part of the review, which culminated in the new long-run Statement.

UBS: Will They Or Won't They?

- The FOMC will adopt outcome-based fwd guidance and shift QE policy at this meeting.
- If the FOMC does not follow up their change in words with a change in actions, it could severely undermine the messaging of their commitment to the new strategy. Communication from many FOMC participants just before the blackout period, however, showed little urgency in adjusting forward guidance.
- Powell can easily get the Committee there, but the outcome is far from assured.
- The Fed will commit to holding the target rate at the ZLB until the FOMC's forecast for inflation one year forward is "at or above" 2¼%. They will want to phrase the commitment in terms of achieving full employment and the overshoot.
- The Fed will also extend the maturity of Tsy purchases to 5 years and longer (no point buying <=5 with short end pinned down), but also slow from the current $80bln/month, in a shift from 'market functioning' to providing accommodation (while acknowledging concern about the balance sheet growing too big too fast).

- There are many ways for the Fed to disappoint, and hard for it to outperform. Based on conversations with clients, the lack of any specific, concrete action by the Fed to achieve its revised policy goals would be seen as underperformance by the central bank.
- Fwd guidance unlikely to move the needle much with front-end rates (no hikes priced before 2025).
- If the Fed shifts to longer-dated QE but pares back the dollar amount, the market could worry about reduced policy accommodation. And because the Fed has said that it is concerned about too rapid an expansion in its balance sheet, substantially increasing the scale of QE seems unlikely.
- **SEP/Dot Plot:** One dot to call for a rate hike in 2022 (again), seven others for rate hike in 2023 – but median at zero. Little new info for FOMC to update GDP or inflation forecasts, unemployment rate path to be revised down.
- The world is shifting to a point where the SEP forecast for inflation is as important as the dots: median f'cast for inflation 1.9% in 2023, still short of target.
- **Press Conference**: Powell to reinforce how steps taken at the meeting reinforce new framework. Will likely reiterate calls for more fiscal easing.

Unicredit: Remaining Resolutely Dovish, Action More Likely In Nov Or Dec

- Fed to remain resolutely dovish, and to say the road ahead will be much harder than in recent months.
- Meeting will be an opportunity for the FOMC and Powell to provide more detail on the new framework, on what would constitute "moderately" above 2% inflation and over what horizon.
- However, we do not expect much – if any – further detail, as the committee appears to be being deliberately vague here, which it calls a "flexible" form of average-inflation-targeting.
- Announcement on stronger fwd guidance more likely in Nov or Dec.
- **SEP/Dot Plot:** Rates on hold through 2023. The two who saw a hike in 2022 could fall in line with the rest of the committee. GDP / empl likely to be upwardly revised for near-term, but 2021/medium-term unch.
- Fed could also signal more caution about the longer-run effects of the pandemic by lowering projections for longer-run growth slightly. 2023 PCE infl projections probably signal desire for period of "moderately" above 2%, while longer-run likely unch at 2% (consistent with price stability).

Wells Fargo: FOMC In No Rush To Tie Its Own Hands

- This meeting will afford Powell the opportunity to further expand upon major changes to the Fed's operating framework. Another topic will likely be whether FOMC has moved any closer towards explicitly tying future rate hikes with time- or objective-based metrics, such as the unemployment rate or inflation.
- Our sense is that the FOMC is in no rush to tie its hands in this way, but deliberations are likely to continue at the Sep meeting. the announcement of the new framework in concert with the lower path of the dot plot will allow the FOMC to hold off on any calendar- or threshold-based forward guidance for now.
- There were no immediate answers at Jackson Hole to questions on how much of an inflation overshoot the FOMC will allow without signaling a less accommodative policy path, and we do not expect to get much clarification at this meeting either.
- On asset purchases: a shift to a more traditional QE would put a cap on how high long-term rates can rise from today's levels. Do not expect a shift in the stance on asset purchases at the September FOMC, but a recent speech by Brainard noted the importance of a "pivot from stabilization to accommodation." The comment was not geared directly toward asset purchases, but up to this point the Fed has maintained that asset purchases have been focused on restoring smooth market functioning (stabilization). The speech may have laid the groundwork for an eventual shift to purchases further out the curve (accommodation).
- **SEP/Dot Plot:** Near-term changes should be inconsequential. Vast majority to indicate zero rates still appropriate in 2023 given the new framework.
- Since the inception of the SEP, the committee has anticipated inflation would return to 2.0% within three years' time. With the committee fessing up to the fact that 2% inflation is more difficult to achieve than previously envisioned, we would not be surprised to see the median for 2023 remain slightly shy of 2%.
- Projections of longer-term infl should be unchanged; long-term unemployment est could fall marginally.

Westpac: Potentially Room For More Easing In Future

- Following Jackson Hole, there is cause for the current mon pol stance to be maintained for the foreseeable future, and potentially for more easing.

- Updated forecasts and the Committee's assessment of risks will therefore be closely scrutinised, despite policy remaining on hold this month.

Wrightson ICAP: Not Enough "Facts" Yet To Take Action

- While some sort of outcome-based (as opposed to calendar-based) fwd guidance is likely at some point, the timing and nature of that guidance is uncertain.
- Seems unlikely FOMC will reach a conclusion on more specific fwd guidance this week. They may massage the statement to reflect the FOMC's new longer-run strategy framework, but don't expect it to introduce any short-run numerical guidance at this meeting. There are reasons to think that the minutes of this meeting might suggest that this debate is still in its relatively early stages.
- FOMC seems quite serious about the "flexible" part of flexible AIT, will be wary of mechanical rules. And Powell said in Jul that concrete fwd guidance needs to be very "fact specific", and the Fed is still short on facts about a number of key economic, public policy and public health questions.
- On asset purchases: at some point, the Fed will rebrand as "monetary policy" rather than "market functioning" and will have to decide whether to skew its purchases toward long end (probably yes), and whether future buys should be linked to macro objectives (unclear at this point).
- The Fed continues to build out its lending infrastructure and will be prepared if a credit crunch requires a substantial expansion of its Treasury-backed emergency facilities in the coming months. The Fed faces far greater uncertainty about competing demands on its balance sheet today than it did during its large-scale asset purchases in the 2009-14 period, which could make it cautious about committing to a specific securities portfolio strategy in the short run.
- No reason to think the Fed sees any need to raise the interest rate on reserves (IOER) at this point. But we cannot rule out the possibility of another increase in the minimum bid rate on the Fed's overnight repo operations (an additional 5bps hike would not come as a major surprise at any point in the coming months).
- **SEP/Dot Plot:** Rate path at zero through 2023. Near-term forecast for unemp to be revised down markedly, but not a sign that Fed feels it is making more progress toward "maximum employment".
- (When the FOMC releases its new projections format in December, it will be interesting to see whether the tradition U3 estimates will be replaced with committee projections of either aggregate employment or the employment-to-population ratio.)
- Near-term core PCE prices likely to rebound higher, but 2021-22 may not be changed much. Big question is for 2023: in June, only one projected core infl >2% in final year of forecast horizon. They may have more company now but only a little, with median of 2.0%, and a handful at 2.1-2.2%.

MNI Policy Team Insights

MNI PREVIEW: Fed 2023 SEP Forecast in Focus, Guidance Delayed (Pub. Sep 14, 2020)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - The Fed will publish forecasts stretching into 2023 for the first time Wednesday, the closest policy makers may get to offering clues on more stimulus as they debate stronger forward guidance to cope with a lingering pandemic.

Fed watchers will pay attention to any changes to the Fed's July statement that the economy and employment "picked up somewhat in recent months but remained well below their levels at the beginning of the year." Since then officials have stressed the need for better adherence to Covid-19 guidelines, the benefits of a longer fiscal bridge and signs that inflation and job gains slowed in recent weeks.

MNI has reported exclusively that officials are reluctant to deliver new forward guidance in September because they are just starting the process of debating its exact form after concluding an 18-month review of its policy framework. Some market participants still see guidance as early as this meeting.

The Summary of Economic Projections constitutes a form of guidance because they include officials' projections for the path of interest rates. Investors will be looking for any signs that some members might be penciling in rate increases in late 2022 or 2023. Only two members saw a 2022 rate hike and several market watchers say that kind of result could be shown for 2023 as well.

--PRESS CONFERENCE CLUES

Fed Chair Jerome Powell's press conference may be the bigger focus for questions about the future path of policy, and perhaps about whether recent dollar weakness affects the Fed outlook. The ECB and other central banks are watching dollar weakness as they seek to restore their own economies, though with less outright complaints about devaluation than 2008-09.

Powell will also likely get pressed on what more the Fed can do to boost the economy in the absence of fiscal stimulus from Congress that appears increasingly unlikely with just a few weeks left before the presidential election.

In response to the pandemic, the Fed cut official interest rates to around zero, swelled the balance sheet to USD7 trillion and launched emergency facilities including corporate and municipal bonds as well as smaller "Main Street" loans.

The programs have seen minimal uptake and reporters will likely ask Powell whether any modifications to the programs, which are backed with USD460 billion in loss-absorbing capital from Treasury, could make them more useful. Lawmakers have been asking the same questions.

--BOND BUYING

The response depends on whether weakness from Covid-19 hits financial markets or the real economy, pressuring the Fed to ramp up emergency lending or opt for more aggressive forward guidance and bond buys.

Ex-officials say the Fed could also soon lengthen the maturities of bonds where its purchases are concentrated to keep long-run interest rates down.

Powell will also emphasize the new long-run framework launched at last month's Jackson Hole conference, including flexibility through an average inflation target and greater focus on getting to full employment. While some Fed officials say the inflation overshoot could be something around 2.5% or less, investors want more detail on how long and how large the overshoot could be.

MNI EXCLUSIVE: US Fiscal Push Could Prompt Year-End IOER Rise (Pub. Sep 9, 2020)

By Evan Ryser

WASHINGTON (MNI) - The U.S. government's gusher of T-bill sales should keep upward pressure on the fed funds market in coming months, but future Congressional stimulus could draw down on the Treasury's swollen cash balance, potentially prompting the Federal Reserve to nudge up its Interest on Excess Reserves to keep rates within its target range, ex-officials told MNI.

The pandemic so far has led to a much greater increase in short-term Treasury securities than in bank reserves, causing upward pressure on the fed funds rate relative to the Interest On Excess Reserves rate, a force which should persist for months, former New York Fed research director James McAndrews told MNI.

"The federal funds rate, the Eurodollar rate, the overnight commercial paper rate cannot be explained well solely by the amount of reserves in the system under our current regime," McAndrews said. "It is not at all clear what changes might be required," especially when the Fed is already buying USD80 billion in Treasuries per month, adding to the pool of reserves, he said.

Todd Keister of Rutgers University, a former New York Fed economist, said the Fed is likely comfortable with the federal funds effective rate currently at 9bps, although "the Fed has at times been a little more sensitive to small movements than expected."

The Fed can use IOER to make sure the fed funds rate stays clearly within its target range. Even small changes in fed funds are closely tracked to make sure monetary policy is set correctly for the big volumes of short-term loans that can guide the rest of the market.

--ADDITIONAL STIMULUS

But upward pressure on fed funds could swing the other way should Congress agree on stimulus, said Jon Hill of BMO Capital Markets and a former debt manager at the Treasury Department. "It makes sense for the Fed to be in a wait-and-see posture on IOER until we have clarity on the path of stimulus and bill issuance," he said.

Fed funds has been high relative to IOER, Hill said, but there is a "downward bias" going to the end of the year with QE and a possible stimulus. "If we see the [Treasury General Account] come back down you'll see rates fall pretty meaningfully" by about 5bps, raising the chances for a IOER hike.

McAndrews estimates that a trillion dollars of additional bank reserves reduces the fed funds rate by 8bps relative to the IOER. An additional trillion dollars of Treasuries with less than a year to maturity tends to increase it by about 3bps.

The surge in the value of outstanding short-term Treasury debt is the dominant force now and seen as likely to continue in the near-term, with issuance of USD8.9 trillion in bills since March and USD2.4 trillion in net new bills from April to August. That more than compensated for the rise in bank reserves from USD1.9 trillion to USD2.9 trillion.

The flip side of this year's record Treasury bill sales is a hoard of cash now in limbo as Congressional talks over another fiscal package flounder. Treasury has been left holding more than twice as much cash than it had expected, at USD1.62 trillion as of Sept. 4. That rise is also due to lower-than-expected use of emergency Fed facilities, and a slow pace of small business loan-forgiveness for the Paycheck Protection Program.

--UNCERTAINTY

With cash on hand, the Treasury could also create overnight market fluctuations by cutting down debt sales. Treasury earlier had projected USD2.2 trillion in additional borrowing in the second half of 2020 assuming a USD1 trillion stimulus. And an influx of quarterly tax payments on Sept. 15 could further alter its calculations of its financing needs.

"As uncertainty persists, we can count on a general account being bigger than it would be normally," said former Fed economist Roberto Perli now at Cornerstone Macro. "Shorter rates will be a little higher than they would have been otherwise."

"When you issue a quarterly refunding statement you tend to stick to it and you borrow no matter what. If it doesn't materialize then you deal with it in the next quarterly period," Perli said.

It is "prudent" that Treasury is holding an elevated cash balance, said Hill, the former Treasury debt management official, and "the bar to deviate from the quarterly refunding statement is extremely high."

MNI EXCLUSIVE: Expanding Fed Corporate Bond Buys Won't Be Easy (Pub. Sep 4, 2020)

By Jean Yung and Pedro Nicolaci da Costa

WASHINGTON (MNI) - The Fed could soon face pressure to buy more junk debt to forestall a wave of bankruptcies as the pandemic wears on, but concerns over moral hazard and lost independence may prove harder to overcome than in the first corporate bond program, former officials told MNI.

The U.S. central bank has so far managed to boost asset prices and ease borrowing costs by tapping just a fraction of its emergency lending capacity. But as the coronavirus continues to spread and fiscal aid in doubt, investors will lobby for greater support via the deployment of USD260 billion in unused Treasury funding earmarked for emergency Fed programs.

"If the economy is going to get worse, not better, over the next three quarters, or if they find that inflation is moving down, then that's when I think they will take forceful action" by scaling up QE and corporate bond buying, said Bill Nelson, former Fed deputy director of monetary affairs and current chief economist at the Bank Policy Institute.

"When the Fed decides to go for shock and awe, it will increase the size of these purchases. It could also extend eligibility to slightly-below-investment grade bonds as it has already done for its primary market purchases of corporate bonds."

--WORKING SO FAR

One reason to expand the corporate bond program is that it's extremely effective. The Fed's promise alone to purchase corporate bonds on March 23 sparked a sharp rally in markets and opened the floodgates for new sales.

"Right on announcement, we saw a major relaxation of trading costs for eligible bonds," said Mahyar Kargar, an economist at the University of Illinois at Urbana-Champaign and co-author of a National Bureau of Economic Research working paper studying the unprecedented lending facility. "When the program was extended to fallen angels on April 9, liquidity conditions improved again," because bondholders felt assured they would always have a buyer in the central bank.

Some high-yield ETFs saw their largest one-day rally since 2008 on the news. High-yield spreads have narrowed by over 1,000 bps in late March to just under 475 bps this week, according to a Mizuho client note.

Investment grade spreads have fallen to 128 bps from over 373 bps immediately after the Covid-19 lockdowns were implemented.

--MORAL HAZARD

To date, the Fed has bought just USD12.6 billion of corporate bonds, well short of the USD750 billion capacity. Only 3% of its holdings are rated junk as of July 31, the latest data available.

"It's very remarkable that the credibility of their commitment was so powerful that private market participants did all the work. But what if private market participants become more skeptical?," said Kim Schoenholtz, an economist at New York University. That would force the Fed to purchase more bonds and riskier ones to stabilize spreads, he said.

But if the Fed is seen lending to increasingly insolvent organizations, its loans may become stigmatized, Schoenholtz said. "It would undermine their role as the lender of last resort."

--TREASURY STEPPING IN

Schoenholtz believes the longer the Covid recession lasts, the more appropriate it becomes to build a Treasury fund covering non-financial companies, rather than burdening the Fed in a way that threatens its independence.

The Fed prides itself on never having lost a cent on any lending program in the financial crisis and would like to keep it that way, former senior Boston Fed official Jeff Fuhrer told MNI. The central bank would venture further into junk territory "only if they got the Treasury to pony up a significant amount of additional collateral backing," he said. "That's getting further into the fiscal policy domain, they're going to get heat from Congress."

Nevertheless, the perception of responding to a weak economy with quick action may see government approval. "Treasury is in the first-loss position. So they are the ones that are exposed at the margin," said former Fed Governor Jeremy Stein. "Thus far, Treasury has been very protective and not much willing to give up on the seniority or security of their position."

MNI EXCLUSIVE: Fed Needs til Dec to Meld Framework on Guidance (Pub. Sep 1, 2020)

By Jean Yung and Evan Ryser

WASHINGTON (MNI) - The Fed will wait until December or longer to clarify forward guidance implementing the shift to average inflation targeting, but new 2023 projections in the September dot plot should guide markets toward a later lift-off date, former senior officials told MNI.

There's little urgency to pledge near-zero rates for a specific period of time or until some economic threshold is met, because there's no assurance Covid-19 is under control or the U.S. economy is in a sustained rebound, sources said. Congress failing to pass another fiscal aid package poses another risk, so staying out of the way also keeps up pressure to enact more stimulus, they said.

"They will be giving it a couple more months before bringing out the heavy guns," former Richmond Fed President Jeffrey Lacker told MNI. The Fed is waiting to see whether the economic rebound remains stalled or resumes a brisker pace before issuing outcome-based forward guidance on rates and asset purchases, he said.

A new Summary of Economic Projections at the September 15-16 meeting that extends the forecast horizon to 2023 could illustrate a "general intent to be more dovish than in the past," Lacker said. "That's the kind of thing you would see, that they would tolerate two-and-a-quarter maybe even two-and-a-half percent core inflation over the course of three years or more In a row."

--Persistent Overshoot Needed

Nathan Sheets, a top Fed and Treasury official, now chief economist at PGIM Fixed Income, anticipates only one additional dot supporting a rate hike by 2023. "It's a persistent overshoot they've got to achieve, and that's a high bar. (In June) you had two dots above zero and this time you'll have three, and all the rest will be at zero," he told MNI.

Trying to jolt short-term rates now would likely add little to the QE already in place, and the Fed was also wise in July to state that it still has flexibility to respond at any point to the evolution of the pandemic, Lacker said. "They've done a lot in asset purchases, so it's not clear they would be able to generate the same shock and awe that shifts expectations," he said.

Former Atlanta Fed President Dennis Lockhart also told MNI the Fed is likely to take some time before weaving in the new framework. "Current conditions don't call for implementation of the new approach," he said.

"To the extent that forward guidance is a policy tool to add stimulus, it may be premature, or it may be adding stimulus in a potentially rapidly shifting economic picture," Lockhart said."If we see an acceleration of inflation to above 2%, the committee will let the economy run and measured inflation to continue above target for potentially a long while."

--Jobs Goals

While the Fed has set its new average inflation goal, it hasn't said how it's going to get there. Part of the answer will be embedded in the specifics of its outcome-based forward guidance, still very much under debate.

Bill Nelson, former Fed deputy director of monetary affairs and current chief economist at the Bank Policy Institute, anticipates inflation-dependent guidance. The Fed will specify that rates remain near zero for "at least as long as 12-month PCE inflation measured over a two-year period averages 2 percent or less," he said. That implies the Fed would let unemployment fall without limit, he said in an email newsletter Friday.

Others expect a more explicit reference to a job market objective, especially given the difficult process of bringing workers back. "It's hard to imagine," Lockhart said, "that the committee would remain silent on employment in laying down a marker as to how long we'll have the policy rate at the zero lower bound."

Communicating labor market conditions that would prompt a withdrawal of monetary stimulus -- in light of the Fed's new "broad-based and inclusive" goal -- will be a separate challenge, he said.

--Fiscally Active

It's important that the Fed get the structure of guidance right to preserve its own powers, said David Wilcox, former director of research at the Fed Board of Governors. Scope for monetary action is constrained by rates stuck near the zero lower bound, he said. The framework may allow new tools to regain more space for monetary policy while nudging other policy makers to do more.

"Fiscal policy will have to step up and play a much more active and systematic role in fighting recessions in the future than was the norm in the past," he said.

MNI EXCLUSIVE: Pressure On Fed To Boost Main Street Lending (Pub Aug 28, 2020)

By Pedro Nicolaci da Costa and Evan Ryser

WASHINGTON (MNI) - The Federal Reserve is facing growing calls to broaden access to its Main Street Lending Facility or risk a K-shaped recovery which sees big companies survive while smaller businesses fold, former Fed officials told MNI.

The Main Street Facility has so far disbursed just USD898 million, a paltry figure compared to the USD75 billion in designated Treasury equity that the Fed had touted as potentially generating as much as USD600 billion in loans. Ex-officials noted the minimum loan threshold of USD250,000 excludes too many businesses, including customers of the 1,000 or so Community Development Financial Institutions (CDFIs) that serve low-income and minority communities.

"While the Fed has given champagne to the biggest companies, via its easy corporate bond programs, smaller businesses are being forced to catch the drops via a program that is currently not easily accessible," Sarah Raskin, former Fed governor, told MNI.

"This differential kind of relief means that size, more than creditworthiness, determines access to credit."

The Fed is administering the program through large banks, which have little interest in making high risk, low return loans to smaller borrowers. Instead, lenders have tended to direct capital to large firms with which they have existing relationships, a pattern reinforced by the speed of disbursement in the first round of fiscal stimulus.

--BUSINESSES FAILING

And yet small businesses could badly use an influx of capital. Research cited by the New York Fed suggested active black business ownership declined by 41% between February and April.

The Main Street program not only took three months to come online, but when it did its terms were too stringent for firms that really need money, despite its loss-absorbing Treasury backstop. Meanwhile, companies in a strong financial position can borrow more favorably elsewhere.

"The banks don't want to touch this thing with a ten-foot pole," Danielle DiMartino Booth, a long-time Dallas Fed economist, told MNI. "The liquidity transmission mechanism is completely broken and it has to be very troubling to them given they are at the lower bound (on the fed funds rate). It's a frightening thought because businesses need credit."

The joint-custody arrangement with Treasury also makes it unclear who is leading the charge, complicating accountability, sources said.

Policymakers are concerned about what some are calling a K-shaped recovery -- one where big businesses thrive, or at least recover, while small ones fold.

Patrice Kunesh, former head of Minneapolis Fed's Center for Indian Country Development, told MNI the divide happens not just because of a lack of interest on the part of banks but also a lack of financial acumen and administrative capacity in the small business itself.

Unlike large firms, mom and pop operations rarely have someone focused solely on raising capital as their job rather than running the business.

--MORE LENDING NEEDED

"I do think the Fed is missing Main Street," said Kunesh. "My experience is that CDFIs, especially in the more rural communities, really have their ears tuned to what the communities need."

Ex-Fed Chair Janet Yellen is among prominent former policymakers calling for an expansion of lending targeted toward the greatest need.

"I would love to see the Fed and Treasury explore a 13(3) (program), maybe something through the main street facility, through CDFIs, though would be oriented toward low and moderate neighborhoods and banks," Yellen told Congress in July.

CDFIs are private lenders but are not regulated like banks and can tailor loans more appropriate to smaller, less conventional businesses. They are backed by the Treasury's Community Development Financial Institution Fund, whose mandate is to expand lending to needier, more financially-stressed populations.

Some sitting Fed officials, like San Francisco Fed President Mary Daly, remain hopeful about the program's future.

"I see those positive developments occurring and it is a vital component of the package of support we are giving to the economy, and I wouldn't be surprised if take-up goes up," Daly told reporters last week.

However, Raskin and others worry that might be too little too late for a sector which could see a large swath of firms go under in six months.

"The program has had a rocky start -- with different criteria at different times -- and later than ideal to help keep midsized firms from having to lay off workers," Raskin said.

MNI POLICY: Fed Targets Inflation Overshoot, Jobs Gap (Pub. Aug 27, 2020)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - The Federal Reserve on Thursday ditched a fixed 2% inflation target in favor of allowing some overshooting around an average rate, and will also now target the shortfall from full employment and take more account of financial stability risks.

The long-awaited shift in its policy framework came sooner than some market expectations for a conclusion at next month's FOMC meeting. The Fed said it was a recognition both of the benefits of running a hot labor market and the difficulties of conducting monetary policy when interest rates are already at zero.

The Fed's shift toward an average inflation target was announced alongside prepared remarks from Fed Chair Jerome Powell to be delivered before a remotely-held Jackson Hole conference, the Kansas City Fed's widely-watched and internationally-attended research symposium.

"Our revised statement reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities, and that a robust job market can be sustained without causing an unwelcome increase in inflation," Powell said. His speech largely avoided any issues related to the current outlook for the economy or monetary policy.

On the employment side of its mandate, the Fed shifted its language to say its judgments would be defined by "assessments of the shortfalls of employment from its maximum level," instead of "deviations from our maximum level."

--Moderately Above 2%

The Fed shifted toward an average inflation target that largely recognizes the central bank's persistent shortfalls from the 2% target--and a desire to make up for them in the future.

"Following periods when inflation has been running below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time," Powell said.

In response to the pandemic and the related economic slump, the Fed cut official borrowing costs rapidly to zero in March, and launched a number of emergency lending facilities aimed at reviving frozen credit markets.

The Fed also said the changes "explicitly acknowledge the challenges for monetary policy posed by a persistently low interest rate environment. Here in the United States and around the world, monetary policy interest rates are more likely to be constrained by their effective lower-bound than in the past."

"Sustainably achieving maximum employment and price stability depends on a stable financial system. Therefore, the Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals."

The FOMC will now undertake a public review of its monetary policy strategy roughly every 5 years.

MNI EXCLUSIVE: Fed Sees Stimulus Bump From Weaker Dollar (Pub Aug 17, 2020)

By Jean Yung and Evan Ryser

WASHINGTON (MNI) - The Fed likely welcomes the U.S. dollar's slide for giving a small boost to flagging inflation and exports to Europe, where growth is pulling ahead on more effective government relief spending and pandemic containment, former officials told MNI.

"Relative to a world in which the dollar remained at its March 23 level, the depreciation since then will make the Fed's job of attaining its dual mandate a little easier," former Fed Board research director David Wilcox said in an interview. The dollar back then was at a 3-year high against the euro and a multi-decade high against the pound, and has come down 10% against a basket of currencies.

"The dollar has depreciated for undesirable reasons, importantly having to do with a failure to bring the virus under control" and the growing gap between U.S. and European growth prospects, Wilcox said. "It will serve as a shock absorber to offset some of the effect of the fiscal negotiations" that have stalled in Congress.

"From a strictly domestic point of view, you would probably say some weakness in the dollar is good," former Minneapolis Fed President Gary Stern told MNI. The depreciation "will benefit some sectors of the economy," particularly exports, even for a U.S. economy geared more towards domestic demand, he said.

--LOW ON RADAR

The U.S. dollar dropped 5% in July against a basket of currencies, the steepest monthly decline in more than a decade. That undid the 8% appreciation in the second and third week of March when fears of a global dollar shortage prompted the Fed to open emergency swap lines with other central banks.

One thing the dollar reflects is market skepticism that unprecedented Fed balance-sheet stimulus will create much inflation, which was 1% in July. Wages are also being held down by unemployment that hit a record 14.7% during the health shutdown.

So far, Fed officials have followed their traditional reluctance to comment on the dollar's value out of deference to the Treasury, and unlike the global financial crisis the U.S. isn't being accused of using a weak dollar to prop up its economy.

Policy makers like Jerome Powell and Mary Daly have often said the most urgent need is a strong health and fiscal response to put money in people's pockets while monetary action shifts from stabilizing money and bond markets to supporting an economic recovery.

With those issues in the forefront, "the dollar hasn't garnered a lot of broad attention," Stern said. "I don't think it's high on the policymakers' agenda at the moment."

--TREASURY GLUT?

Still, the dollar may weaken further if demand for Treasury securities is hurt through a prolonged U.S. recovery that creates a wave of new supply, former officials acknowledged.

"The bigger threat is Congress won't spend enough to prop up the economy," Wilcox said. Given the struggle to contain Covid-19, the dollar weakness "is clearly a better world" for the U.S. economy, he said.

MNI EXCLUSIVE: Fed May Specify Conditions for Ending Bond Buys (Pub Aug 6, 2020)

By Pedro Nicolaci da Costa and Jean Yung

WASHINGTON (MNI) - The Fed is strongly considering linking QE to inflation and employment, adding weight to promises of rock-bottom interest rates until the economic recovery is well in place, according to interviews with current and former senior Fed officials.

The move would mark a significant shift from market expectations of more explicit forward guidance focused solely on when interest rates would rise again.

With official rates lowered to near-zero since March and expected to remain there for the foreseeable future, sources told MNI that more specific guidance about the future path of official borrowing costs may not be that useful to markets. Instead, they said, Fed officials may opt for a more aggressive approach that includes the central bank's expectations for when to end its bond purchases.

Internal discussions involve how to shift purchases to the long end of the yield curve and at what pace, but Fed sources generally expect to maintain purchases until the economy has sustained the 2% inflation target for a time and the sky-high unemployment falls to levels more commensurate with a healthy economy.

"It's feasible -- they've done that before," said Jeff Fuhrer, who spent nearly three decades at the Boston Fed. He pointed to the QE3 purchases after the financial crisis in 2012 that linked bond buys to material improvements in the labor market as a precedent.

--IMPROVING ON QE3

Tying large-scale asset purchases to the state of the economy "makes sense," Chicago Fed President Charles Evans said in response to a question from MNI at a meeting with reporters on Monday. Cleveland Fed President Loretta Mester on Wednesday said offering explicit guidance on rates and QE is a tool that can be deployed to support the recovery,

David Wilcox, former research director at the Fed Board and a senior fellow at the Peterson Institute for International Economics, said specifying the conditions that would have to be met before the FOMC would consider terminating bond purchases would "harness market expectations" in service of the recovery.

The Fed would "get a lot of punch right now" because long rates would decline based on expectations of larger Fed purchases, especially if investors see "a really dark future," he said. The guidance would also make clear that what the Fed ultimately cares about is the economic outcome, much more than the specific amount it ends up purchasing, Wilcox said.

"This is a way that monetary policy can build in some automatic stabilizer properties even when the fed funds rate is pinned at the zero lower bound."

--TWO-PART TREATMENT

Failing to clearly link balance sheet policy to forward rate guidance has frustrates Andrew Levin, a former special adviser to ex-Fed Chair Janet Yellen. Interest-rate guidance without saying much about the pace of bond purchases would be counterproductive, he said. "It's like doctors telling a patient they're not going to push them out of the hospital prematurely, which is nice, but they're also not saying anything about what they're going to do to make the patient better," he said.

The FOMC has promised to keep rates near zero until it's confident that the economy is on track to maximum employment and price stability and to keep up the current pace of asset purchases to sustain smooth market functioning. Officials were expected to deliver more explicit forward guidance on rates as early as this summer as policy transitioned from market triage to more regular economic stimulus. Those plans have been thrown into disarray by persistent and growing infections that could slow the economy again, erasing clarity about the future policymakers could use to anchor their guidance.

Chair Jerome Powell has already also played most of his hand on promising low interest rates through the recovery, telling reporters last month that policymakers "are not even thinking about thinking about raising interest rates."