

Transcript

Bill Emmons: Hi, I'm Bill Emmons and I'd like to talk about the FOMC meeting that took place September 15th and 16th. Today is Monday, September 21st. So, the main meeting takeaways include the fact that there were no changes made to the monetary and financial policy settings already in place. I contrast that with a new monetary policy framework that the FOMC is calling Average Inflation Targeting was announced in August. And there was quite a bit of discussion of that at the press conference.

The FOMC at this meeting upgraded its assessment of the economy through year-end 2020, but still expects it will take at least six years, and probably longer, to get back on the growth path we were on before the pandemic hit. It's interesting to note that two committee members dissented from this decision to keep the settings unchanged and the outlook unchanged for policy. But it was from different ends of the policy spectrum. One member wanted more flexibility to raise rates, the other wanted more of a commitment to keep rates very low in the long term.

So, looking at those economic projections, the summary of economic projections, the SEP, that come out four times a year, the main differences in September versus June included now the unemployment rate's expected to decline faster, reaching 7.6% in the fourth quarter of this year, down from the 9.3% level they expected in June. Real GDP growth is now expected to be only negative 3.7% this year, rather than 6.5%. At the same time, growth rates in '20, '21, and '22 were downgraded slightly. Inflation is now expected to run a bit closer to, but still below, 2% through 2022. And the period with a near zero Fed Funds rate was extended one year, through at least the end of 2023.

These projections also include the members' longer-run expectations. For real GDP growth, that number was edged up just a little bit from the median number from 1.8 to 1.9%. The long-run unemployment rates, inflation rate, and Fed funds rate expected by the median number were unchanged—4.1% for unemployment, inflation at 2%, and that long-run normal Fed funds rate target is at 2.5%.

So, if you look at the June projections of unemployment for the end of 2020, '21, and '22, you can see that the FOMC was expecting almost 10% unemployment still at the end of this year. Well the rate's come down faster than expected, and so now the committee expects that that rate will be about 7.5% at the end of this year, falling in each subsequent year and reaching 4% by 2023. And that's significant because the longer-run normal expected unemployment rate's only 4.1%. So, this essentially says that the FOMC sees the period of above average growth ending by 2023.

So, now looking at real GDP, the total output of goods and services—also, you can think of it as the income earned by our national economy. In June, the FOMC was expecting a very deep decline in 2020, with the gap closing slowly over several years. The projections put out at this meeting suggest that the drop will be not quite as big, not quite as big of a hole, and slightly slower recovery. Now, after 2023, there were no specific projections made.

One assumption you could make is that after 2023, the latest projected growth rate, 2.5%, would continue. If that takes place, it would be about 2026 when we'd get back to that path of the economy's output that we expected before the pandemic hit. Under this scenario, which I'm calling an optimistic scenario, you can see,



September 21, 2020

FOMC Upgrades 2020 Economic Outlook But Remains Cautious

year by year, the shortfalls in GDP or income each year. That sums up over that period of shortfall to 15.6% of a year's income, or about \$3.3 trillion. So, this is a very, very major hit the economy takes as a result of the pandemic.

But, of course, it's also possible that that growth after 2023, when the unemployment rate suggests we may be back close to the natural level, if it reverts to the long-term growth rate of 1.9%, you can see with the second dashed line there—that, in fact, is then going to lock into place permanently this decline in the level of GDP relative to what we expected. So, the cumulative permanent loss then would be much larger even than that \$3 trillion estimate.

It's also notable that large banks, here defined as so-called category 1 banks, weekly reporters, which account for 66% of all banking assets, have continued to push up their ALLL very sharply. Now, of course, obviously, a CECL transition has something to do with this. But it's also true that banks are looking at probably higher losses in the years ahead. And you can see that even in historical comparison, only the Great Recession is anything like what we're seeing right now in the large increase in large banks loan loss allowances.

So, what's this mean for banks? I think the Fed is a bit more optimistic about the 2020 economy, but remains cautious about the medium- and even the longer-term outlooks. A deep recession and the permanent economic damage that we're seeing suggests banks' loan losses will be elevated for some time. And short-term interest rates are likely to stay near zero for at least another three years. And if you look into the long-term interest rates markets, they suggest it might even be low forever, looking way out into the distant future.

So, what should we expect? The pandemic continues and it remains the main driver of economic developments, as Chairman Powell emphasized once again and this statement emphasizes from the Fed's perspective. The timeline for a return to normality has been pushed back a bit. And permanent economic damage now appears likely. The states in our district are highly affected by the pandemic and the associated incomplete recovery. But I think it's worth noting that Chairman Powell and this statement emphasize the Fed's vigilance, but pointed to the need for more fiscal support for businesses and households as we look through to that period when we get past the ravages of this pandemic.

Thanks for listening and we'll see you next time.

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