

## Transcript

**Bill Emmons:** Hi, I'm Bill Emmons, and today is March 19th. I'd like to talk about the FOMC meeting that took place March 16th and 17th. I'd characterize this meeting as signaling a brighter economic outlook from the Fed's perspective. That's being accompanied with rising bond yields, but so far no change in Fed policy.

So the meeting takeaways include unchanged interest rate targets. The fed funds target range will remain zero to a quarter percent, interest on reserves at ten basis points, and the large-scale asset purchases will continue, treasury securities at about an \$80 billion per month pace, mortgage-backed securities about \$40 billion a month.

The really important information out of this meeting is the Fed sees a stronger economic outlook. That includes faster economic growth and higher inflation. Fed policymakers will be patient, and they will continue to support the economic recovery.

So, the key aspects of that brighter economic outlook the Fed sees includes economic growth in 2021 now projected to be 6.5% from the end of '20 to the end of '21. That's up from the December projection of only 4.2%. Unemployment, similarly, is now projected to go down to 4.5% by the end of this year. That's down a full half percent from the previous forecast. And inflation now in 2021 is projected at 2.4%, up from 1.8, and each of these is the median projection made by members of the FOMC reported quarterly in the summary of economic projections.

So let's look at those individually. Economic growth measured from the fourth quarter of one year to the next starting with the June 2020 survey summary of economic projections you can see has moved a lot. Last year in June, a lot of pessimism about the outlook—6.5% decline expected. By the end of the year, December, the projection had come up to about 2.5%, which is about where we ended up with the actual data.

For 2021, last June's projection was that there would be a 5% growth this year. That softened in the next few quarters, and only at this meeting in March, after the big fiscal package was passed, now the Fed's looking for 6.5% this year. Smaller changes in the 2022 and '23 areas.

As for unemployment, very large decreases in the level of unemployment expected at each of these forecast horizons. Big decline last year, down to 6.5% by the end of the year. That was expected to be the level—of 6.5%—as of the June forecast for 2021. You can see now that the Fed is looking for a 4.5% unemployment rate. Big, big improvement there. And, similarly, in 2022 and '23, some improvement.

As for inflation, higher inflation is coming, and the Fed sees that as a good thing. We've been below 2% most of the last decade. So to see inflation at 2.4% this year is actually a very positive development from the Fed's perspective, and then in the subsequent years closer to 2%.

So as I said, the financial markets, of course, also are seeing the signs of a brighter outlook, and the ten-year treasury yield, which the Fed, of course, does not control directly, has moved up quite a bit—in fact, 120 basis points in just seven months, hitting 1.75%. Funds rate is likely to stay very low, and this is sort of a tension between markets and the Fed.

So one way that the Fed communicates the way the members of the Committee are thinking is the so-called dot plot. This is from December of 2020, and it shows the individual members' evaluation of where appropriate monetary policy measured by the fed funds will be over the next few years. The median member is what's usually reported, and I've indicated that here with the red dot. You can see it clearly through 2023, no change in the projected appropriate level of the fed funds target rate. There was a single dissenter for that 2022, expecting one increase, and then at 2023, five members, none of them identified in this communication, seeing liftoff by the end of 2023. Now fast forward to March of 2021, and you can see a larger number of members now sees liftoff at the end of 2023. In fact, fully 7 out of 18, closing in on half of the Committee, now believes there will be an increase before the end of 2023.

So what does a patient Fed look like? Chairman Powell is exerting control, in my view, watching the press conference yesterday. I think he will remain on message, that the Fed will be very supportive despite the rumblings from the bond market that I showed you, from the Committee, and in the media.

I think the FOMC now will wait to see the whites of inflation's eyes before lifting the fed funds rate off zero. And this is a big change from the Fed's preemptive tightening in the 2015–18 period and in earlier cycles. Those were undertaken in anticipation of higher inflation. So the Fed's current message is we will tolerate inflation over 2% for a time and unemployment of 4% or lower before lifting off.

So, implications for banks: Obviously, a stronger economy should increase loan demand, should limit credit losses. Good news there. The steepening yield curve probably will result in improved net interest margins for many banks; but, of course, there are risks from these rapidly rising bond yields. Especially, I would point to the potential weakening of asset prices, including residential, commercial real estate, and the stock market. After all, elevated valuations we're seeing in those markets have been in part justified by very low bond yields, so the reversal of the yields suggests possibly some pressure on those asset valuations.

So what to expect: We probably will see inflation over the 2% target this year. We probably will see a strong economic recovery and rapidly falling unemployment. At the same time, expect the Fed to pretty much remain where we are. The Fed is committed to maintaining a very



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## Brighter Economic Outlook Brings Rising Bond Yields But No Change in Fed Policy

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accommodative monetary policy until the economic recovery is substantially complete, which could mean liftoff taking really until 2024 or later.

Now I think it's important to remember that as we get there, financial market volatility is likely to continue, and I think that will test the Fed's resolve to maintain that accommodative policy, and it could threaten key asset values, which are things we need to keep our eyes on.

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

(END OF RECORDING)