

Transcript

Bill Emmons: Hi. I'm Bill Emmons. And I'd like to talk about the FOMC meeting that took place July 27 and 28. The FOMC remains on hold, even as the economy sizzles like much of the country. Important meeting takeaways include, first, that interest rate levels are unchanged; the Fed funds target range is 0 – 0.25%; the interest rate paid on banks' reserves is 15 basis points and, on the overnight reverse repo rate, 5 basis points. As you know, these are rates at which the Fed will borrow from financial institutions.

Large-scale asset purchases will continue as before, buying at least \$120 billion a month, split into \$80 billion of Treasuries and \$40 billion of agency mortgage-backed securities. There were really no specific hints given at the meeting about when the taper of bond purchases will begin and how fast it will be once it gets underway.

The third takeaway is something new. The Fed established two new standing (that is, permanent) repurchase agreement facilities. The domestic standing repo facility means that the Fed stands ready at all times to lend to primary dealers and banks against Treasury or agency collateral. And, also, the repo facility for foreign and international monetary authorities means the Fed will lend at any time to non-U.S. counterparties, including foreign central banks and multinational financial institutions, against Treasury or agency collateral. So, these are Fed lending facilities comparable to the Discount Window in contrast to those borrowing rates.

So, I think the overall theme of the meeting was that the FOMC continues to hammer home the new policy message, a very accommodative policy for a long time. Before 2020, the FOMC was forecast based. This means that the Fed would adjust policy based on forecasts of unemployment or inflation because monetary policy actions take time to affect the economy. For example, the Fed would tighten policy if indicators of inflationary pressures, not actual inflation, are beginning to build. This was why the FOMC tapered asset purchases and lifted the Fed funds target range off zero in the 2014–2018 period. This tightening strategy is now seen by many members of the FOMC to have been premature.

So, now, the FOMC is outcome based. The Fed will adjust policy only when economic objectives have been substantially or completely achieved. In the case of tapering

the asset purchases, the phrase that the FOMC continues to use, is that substantial further progress toward maximum employment and price stability goals must be achieved.

The chairman stressed at the press conference that we have not yet experienced substantial further progress, in the committee's view, especially toward maximum employment. Market participants generally expect this criterion to be met in late 2021 or early 2022. As for the liftoff of interest rates from zero, actual attainment of maximum employment and price stability goals will be required. This is a change from before 2020. Using the median FOMC members' longer-run projections of the unemployment rate from the June Summary of Economic Projections, which was 4%, and the FOMC's outlook for the economy, this could occur in 2022.

The chairman stated that, ideally, the asset purchase taper would be complete before interest rate liftoff occurs. We got the first look at second-quarter GDP numbers the day after the FOMC meeting. As you know, the FOMC is pursuing a dual mandate—price stability and maximum employment. This graph shows that there's quite a divergence in these measures. Prices, that is, inflation, is running pretty hot right now. Jobs, employment, is lagging. So, that really creates a bit of a dilemma for the Fed. Given that the Fed believes that attaining that employment mandate is absolutely critical, that will be the determining factor in the evolution of monetary policy.

So, what are the implications for banks? The economy is running very hot, including very strong consumer demand, sizzling housing markets, difficult hiring conditions for employers, and the fastest inflation we've experienced in many years. I would point out that the underpinnings of this booming economy won't last forever, policy support eventually will be withdrawn, and pent-up consumer demand will be satisfied.

And, in my view, the economy may be on the verge of overheating; inflation possibly remaining far above that 2% level for some time. And asset markets are certainly at risk of correction.

So, what do we expect? The economy will stay hot for the next few quarters. Extraordinary fiscal policy support will continue in some form into next year. And, as for the Fed, I think it's likely that we'll be getting signals from the FOMC that the beginning of a tapering of asset purchases could begin later this year or early next year. As for the liftoff of the Fed funds rate from zero, it now looks like that could occur in 2022.

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

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