

Transcript

Bill Emmons: Hi. I'm Bill Emmons. I'd like to talk about the FOMC meeting that took place September 21 and 22. This was an interesting meeting, and we got some updates on the taper and liftoff. Important meeting takeaways included unchanged interest rate targets and asset purchases. The fed funds rate will remain in a range of 0% to 1/4%. The interest on reserves remains 15 basis points; the rate on reverse repo operations, 5 basis points. And the bond purchases, for the time being, will remain at least \$120 billion per month.

As I said, we did get some new information. There's information on the bond taper and the pace of future interest rate hikes. So, it looks like the Fed will start tapering its asset purchase program in November or December of this year, ending by the middle of 2022. The first fed funds rate hike looks like it could be coming the end of next year, by the end of 2022. And, as I'll show you in more detail, the Fed published its quarterly summary of economic projections and, not too surprisingly, the Fed reduced its expectations, its projection for economic growth in the year—through the end of this year—from 7% down to about 6%. And inflation, conversely, was revised up from 3.4 to 4.2%.

So, first, looking at economic growth. This picture shows, year by year, what the progression of these projections was over time. So, focusing on 2021, clearly there was a lot of uncertainty, a lot of volatility in the outlook, going all the way back to the end of 2019 before the COVID-19 pandemic. As recently as last quarter, June of this year, the expectation was that the growth rate would be 7% from the end of 2020 through the end of 2021. The most recent projection tapers that down a little bit to 5.9%. And, then, in 2022, there will be some step-down in the level of growth but still above the longer-run, steady-state level of just under 2%.

As for unemployment, the expectation is that it will be about 4.8% in the fourth quarter of this year. Most recently, it was reported at 5.2%. That's up a little bit from 4.5%, which was expected last June, and that's consistent with that slowdown in the rate of economic growth. And, as you can see in the next years—2022, '23, and '24—the FOMC is now looking for unemployment at the national level to be well under 4%. And that 4% level is where we think, sort of, the longer-run, sustainable rate of unemployment is. So, the economy is running very, very strong...now...and will continue to do so.

Then, finally, the inflation projections are the most volatile of all these three that I'm showing you. As recently as just six months ago, the Fed thought inflation would run just a little bit above 2% this year; but, now, in two steps, it's up to over 4%. And, of course, that's the fastest rate of inflation we've seen for quite some time. At this point, the FOMC balance of opinion headed by the chairman, Chairman Powell, believes that this is transitory, that inflation will move back down closer to that 2% range that we're looking for, as soon as next year.

So, we got more information on the bond taper, and the way this was communicated in the FOMC statement is shown here. So, the Fed will be "reducing the pace of asset purchases," and that will not begin—and this is a quote from the statement—"until substantial further progress has been made toward the Fed's maximum employment and price stability goals." Since last December—and that's when the Fed introduced this specific language about substantial further progress—"...the economy has made progress toward those goals. If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted." That would mean that, probably in about \$20 billion increments—rather than purchasing 120, we would start purchasing 100, then 80, 60, etc.—until finishing off sometime in the middle of 2022.

The chairman has been very clear that the Fed would like to move through that bond taper program, finish that before contemplating interest rate increases. Just now, thinking that the taper could be finished by the middle of next year, opens up the possibility that rate increases could come as soon as the second half of next year. And, in fact, that is what the summary of economic projections suggests when you put all of these individual member's projections for the path of the—the appropriate path of the fed funds rate—that we could well see a slight increase in short-term interest rates by the end of next year, followed by some further increases in the years beyond...but still not getting to the 2.5% level, which the Fed sees as the longer-run appropriate level for quite some time.

In our part of the country, in our district in particular, unemployment is already very low. As I said, 4% is kind of that magic number we're looking for. At the national level, that's where we'd like to be. In much of our district, we're already there or below. So, this is a picture that shows, county by county, what the unemployment rate is. Those counties shown in yellow, orange, and red are already below 4%, and that's true of most of the state of Missouri, most of Indiana, northwest and central Arkansas, northern Mississippi, and the Nashville area. Some other counties also fit into that category, but this makes the point that our part of the country is already at that very advanced level of very tight labor markets, and so further growth is just going to put that much more pressure on our markets.

So, the implications for banks? As I said, the economy is running hot. It's running very hot in our district. Labor shortages are constraining many businesses. We know that both from the aggregate information but also from anecdotal evidence that we're hearing from businesses and from bankers. Inflation is running much higher. That's true of consumer prices. We're also starting to see it in wages, much higher than expected than just a few months ago. And the big question remains whether that will prove to be transitory. It now looks likely that interest rate increases could come within a year or so.

So, what should we expect? This year, economic growth is going to be about 6%...add on inflation of about 4% ...that adds up to about 10% growth of nominal GDP. And another way to think about that is that's kind of the pace of business activity or potentially even the growth of bank assets. We haven't seen anything this fast since 1984. That is, in part, resulting then in pressures that are building on the Fed to rein in this roaring economy. So, I think we have to keep in mind that risks to interest rates remain on the upside. That's true both of Fed rate increases and market rates. And, as is true in the past, market volatility is a risk. I think there is the possibility that it could return with a vengeance as we move into this period of increasing interest rates and trying to slow the economy to a more sustainable rate.

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

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