

Transcript

Bill Emmons: Hi. I’m Bill Emmons. I’d like to discuss the FOMC meeting that took place June 15 and 16. This was a meeting that really affected financial markets. So, the main takeaways from the meeting include an unchanged fed funds target range of 0–¼%, but some technical adjustments, according to the chairman on the interest on reserves rate, that’s up 5 basis points to 15 basis points, and the reverse RP facility also increased 5 basis points from zero. The large-scale asset purchases will continue at a pace of at least \$120 billion a month—a split of \$80 billion Treasuries and \$40 billion mortgage-backed securities. The most important takeaways from the meeting, really, are the economic projections—these are quarterly, and they were significantly bullish, in my view. The 2021 economic growth projection now of the median FOMC member is 7%; that’s up from 6.5% in the March projections. Inflation for this year is expected to run at 3.4%, up a full percentage point from the March projections, and the fed funds liftoff date now looks to be in 2023, rather than in 2024.

So, first on economic growth. There’s, of course, been a lot of uncertainty, a lot of change in these projection for 2020 and 2021, as we move through this very unusual cycle. Let’s focus on 2021 and see after the June expectation for 2021 growth being around 5%, there was actually a reduction in the late-2020 projections before, in 2021, moving up significantly now to the 7% level expected this year. As for unemployment, big declines over the past few quarters, and that is remaining at 4.5%, the expected unemployment rate, at the end of this year.

The biggest change, of course, was inflation. The expectation for quarter-four-to-quarter-four inflation this year is now 3.4%. As you can see, that’s way above the 2% longer-run projection, or target, that the Fed has. Fed members continue to believe that inflation will come back down toward the 2% level fairly quickly. So, this was the meeting that everybody’s been waiting for, in a sense, in which the Fed began to talk about talking about tightening. There was actually no hint in the FOMC statement of tighter monetary policy, but the dot plot gave it away. Markets immediately seized on that and now believe that higher rates will be coming sooner than previously thought. In the press conference, Chairman Powell acknowledged that the committee had talked about talking about slowing the pace of asset purchases. He said, “You can think of this meeting that we had as the ‘talking-about-talking-about’ meeting, if you like.”

So, what that means, is that there will come a time—there is no timetable for this laid out by the chairman—but there will be ample advance warning when the Fed begins to taper or slow

down those bond purchases. So, the dot plot is something that gathers, summarizes the views of where each of the members of the FOMC believes appropriate monetary policy, that is the fed funds rate, where that will be at the end of each of several years. This picture shows the end of '21, '22, and '23, and then the longer-run projection for that rate. Back in March, most members were clustered at the very bottom in that 0–¼% range, and that was true of 2022 and '23, so the median member, even in 2023, said no change in this target, at least through that horizon. But then, the June dot plot showed bigger dispersions in the 2023 formation of members, and this is what got people's attention.

So, one way to summarize that information is to look, just counting the number of members in each of those categories, each of those interest-rate target ranges. For 2021, all 17 members, back in December, believed that the target range would be a 0–¼% at the end of this year. Most of them continued to believe that for '22 and for '23, but you can see, even back in December, there were some members who expected by the end of 2023, that an appropriate fed funds rate would be somewhat higher, even as high as a 1–¼% range. Then in March, those members who believed that the range would be a little bit higher expanded, for 2023 especially; and then what came out in the June meeting, was now a majority of members believe that the appropriate fed funds rate will be higher than the current level. You can see that median there runs through that 0.625% level, but there are members who believe that the appropriate policy, even, is as high as 1.625%.

Looking at the 2022 bar, it's still median members saying no change next year, but the direction of change seems to be toward increasing expectations of higher rates, and so we could see that median level move up in future meetings.

So, the impact on markets was pretty significant, especially at the median-term maturities. So, I'm showing here, the nominal Treasury curve on the left and the inflation index Treasury curve on the right. At the bottom of each of those pictures, the dash-line shows the average change in basis points at the 10 meetings prior to this one. You can see, there's typically a small change across the yield curve in both the nominal and the inflation index. The orange line shows that there was a very large increase: 10 basis points at the five-year maturity at this meeting, mostly in response to that dot plot. On the right-hand side, again, the largest increase was at the five-year maturity, up 15 basis points in a single day. It's interesting that at the very long maturities, the 20- and 30-year nominals, very little change, so this didn't seem to affect longer-run expectations very much. And, at the far left of the nominal curve, that slight increase in the very short maturities probably reflects that technical adjustment increasing interest on reserves, and on the RRP facility, which should flow through into other rates including Treasuries.

The economy is doing well, overall, but especially in the central part of the United States. This is a map that shows county by county what the unemployment rate was in April. Counties shown in dark red have unemployment rates above the national average, which was 5.7% in April, not seasonally-adjusted basis. Those counties shown in light red or pink had unemployment rates below the national average. So, let me look a little bit closer, and you can see individual counties in our district are well below that 5 or 6% range; they're in the 4s and

the 3s, even in the 2s. As you move to the eastern part of our district, again, many, many counties with very tight labor markets. Then in the southern part, with the exception of the Mississippi Delta, which continues to have high unemployment rates above the national average, many counties are well below that level, and the same in Arkansas. Many counties in the 4s, in the 3s, in the 2s.

So, our economy is actually running pretty hot right now. So, the implications for banks include that's going to continue. The economy is going to run hot, especially in our district. Inflation will be higher than we've experienced for many years, and I think this is a symptom of tensions in the economy between demand and supply as we exit this very unusual recession. And, as markets showed us yesterday—or through the week—interest rate increases are back in focus.

So, what should we expect? This year is likely to be a blow-out year for economic growth. We could hit 7%, which would be the highest in many, many years. Inflation could be in the 3–4% range, also the highest in several years. So, it's not surprising to say that risks to interest rates are probably tilted upward, especially in those intermediate maturities at two–five years; and as for the Fed, I think the Fed is likely to signal the tapering of asset purchases within the next few months. In fact, market participants are expecting tapering will begin sometime next year. The question, of course, is whether this will trigger another taper tantrum in markets as we saw back in 2013.

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

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