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Global Economic | Volatility

With no interest rate hikes on the horizon, the Fed moves to tackle the yield curve

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Boston - It was certainly a very dovish June meeting of the Federal Open Market Committee (FOMC), with Chair Jerome Powell taking interest rate hikes off the table for the foreseeable future. "We're not thinking about raising rates —we're not even thinking about thinking about raising rates," he said at the press conference.

Additionally, the Federal Reserve's so-called dot plot, which reflects the forecasts of the central bank's policymakers, came out with a virtually unchanged interest rate through 2022, at the end of the Fed's forecast horizon.

The Fed also announced monthly quantitative easing (QE) levels of about $80 billion of Treasurys and roughly $40 billion of agency mortgage-backed securities. That number has come down with the Fed tapering a bit over the past few months, but the policymakers committed to doing at least that much going forward to keep the market functioning appropriately.

Prospect for yield-curve control or interest-rate caps

Powell alluded to the prospects of the Fed enacting yield-curve control or interest-rate caps for the first time since the 1940s to curb rising Treasury security rates and yields, while keeping borrowing costs low for businesses and consumers. He suggested that policymakers could make some more formal changes to forward guidance or add some type of yield-curve control at the September FOMC meeting.

What seems clear is that the Fed is transitioning away from a primary focus on market functioning, while not fully there yet in terms of exactly what type of forward guidance or yield-curve control they're going to use. And policymakers may be even more aggressive with QE going forward. But all in all, it was a very a dovish meeting. Furthermore, the Fed's forecast of inflation —with core PCE inflation[1] not expected to get up to 2%, even by the end of 2022 — is yet another dovish signal to me.

One last highlight: Chair Powell pushed back on the concern about asset bubbles forming. It's very clear to me, given where we are on the growth/inflation outlook, that the Fed will keep pushing policy in a dovish direction, and rising asset markets won't deter them at all. Said Powell:

> Our principal focus, though, is on the state of the economy and on the labor market and on inflation... I would say if we were to hold back — we would never do this, but the idea that, just the concept that we would hold back — because we think asset prices are too high... What

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would happen to the people that we're actually supposed to be serving? We're supposed to be pursuing maximum employment and stable prices, and that's what we're pursuing.

Bottom line: Expect the Fed to transition to a focus on more "traditional" monetary policy, with a focus on finding ways to invigorate growth amid a weak economic environment.

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[1] Personal Consumption Expenditures (PCE) Price Index is the primary inflation index used by the US Federal Reserve when making monetary policy decisions.