Economic highlights from the week ending on September 18, 2020

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As expected, the Federal Open Market Committee (FOMC) kept monetary policy unchanged this week with the fed funds target rate in a range of 0.0% to 0.25%. Monetary policy remains highly accommodative and Fed Chair Powell maintained a dovish tone during his press conference. The Fed will continue to use its balance sheet to support smooth financial market functioning by purchasing Treasury and agency mortgage-backed securities and will continue to use its lending facilities to support the flow of credit to businesses and municipalities, as needed. However, the Fed has not provided any guidance about how large it would allow its balance sheet to grow or what triggers would cause the Fed to start unwinding its balance sheet at some point in the future. Since February, the Fed's balance sheet has increased from about $4.2 trillion to over $7.0 trillion. The Fed's asset purchases increased rapidly in March, April, and May but have since stabilized. In the policy statement this week, the FOMC noted that inflation continues to run below its 2.0% target, as weaker demand and lower oil prices are holding down consumer prices. Longer-term, the FOMC will allow inflation to run above 2.0% for some period of time before it looks to tighten policy, which implies the fed funds target rate will remain anchored near zero for years. The Fed's updated summary of economic projections signals that the target fed funds rate will remain unchanged through at least 2023, as policymakers do not expect inflation to exceed 2.0% during that timeframe. Notably, the Fed's forecasts suggest increased optimism about employment with policymakers projecting a decline in the unemployment rate to 7.6% by year-end 2020. Furthermore, the Fed expects the unemployment rate will continue to steadily decline over the next few years to 4.0% by the end of 2023. While the Fed's dot plot indicates there is a solid consensus among policymakers about the current stance of monetary policy, there were two FOMC members that voted against the policy action this week (Robert Kaplan and Neel Kashkari) who preferred a slightly different way of articulating longer-term guidance.

The Fed's highly accommodative monetary policy framework, along will a swift and robust fiscal policy response from the government earlier this year, has provided support for the economy and financial markets during the pandemic. However, recent economic data suggests that the economic recovery is losing steam. The pace of labor market improvement has slowed, retail sales were weaker than expected in August, housing starts slowed in August, and the index of leading economic indicators (LEI) remains in recession territory. According to the Conference Board, the LEI suggests that the US economy will head into 2021 under substantially weakened economic conditions. In our view, until there is a widely available COVID-19 vaccine, a more robust economic recovery may hinge on additional fiscal support by the government, but at this point Congress remains at an impasse over another fiscal relief package. We still think a deal is possible in the next two weeks, but the absence of additional fiscal relief in the near-term and the potential for chaos regarding election results, could fuel financial market volatility over the next few months. In our view, expectations for a widely available vaccine by mid-2021 are largely priced into the financial markets, and any news headlines to the contrary would have an impact on market volatility as well.

Next Week

Chicago Fed National Activity Index, Existing Home Sales, FHFA House Price Index, New Home Sales, Durable Goods

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