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What's the Federal Reserve's outlook for monetary policy?

06/16/2021

Jordan Jackson

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Global Market Strategist

At the June meeting, the Federal Open Market Committee (FOMC) signaled a more hawkish stance towards its monetary policy outlook driven by a materially stronger growth and inflation outlook in the medium term. The committee voted to maintain the current federal funds target rate at a range of 0.00%-0.25% and reaffirmed its commitment to $120bn in asset purchases per month, until the committee feels "substantial further progress" has been made towards its inflation end employment goals.

Although a technical adjustment, it also increased the interest rate paid on excess reserves (IOER) and the overnight reverse repurchases agreement rate (ON RRP) by 5 bps to 0.15% and 0.05%, respectively, in order to support smooth functioning in short term funding markets.

Relative to the April meeting, the statement language highlighted the continued improvement in economic conditions due to progress on vaccinations, but noted risks to the outlook still remain. Moreover, even as recent inflation readings have exceeded expectations, the committee still cites these higher prints as being driven by transitory factors.

Elsewhere, as highlighted in the table, the Fed delivered meaningful forward guidance by way of its updated summary of economic projections. Real GDP was upgraded from 6.5% to 7.0% y/y in the fourth quarter of 2021. It also lifted its 2023 GDP estimate by 0.2%, potentially considering some further fiscal support impacting the economy. Core and headline PCE inflation were revised markedly higher to 3.0% and 3.4% y/y respectively in

2021, and slightly higher in 2022 and 2023. Together, this reflects the strong improvement in the broader economy and aggregate demand as vaccinations allow for a robust reopening.

While the unemployment rate has fallen by 0.5% to 5.8% in the first five months of the year, the recent pace of improvement has slowed. Despite this, the committee still expects the unemployment rate will fall to 4.5% as projected in March, suggesting an average decline of 0.2% per month for the remainder of the year as the economy reopens and generous unemployment benefits expire. Overall, the statement and committee projections reflect the committee's view that fiscal support and continued vaccination efforts will provide a strong boost to growth and strengthen the recovery in the labor market, while potentially causing more persistently higher inflation than originally forecasted.

Perhaps most notable, the median dot plot now reflects two rate hikes sometime in 2023, up from no rate hikes just three months ago. Moreover, 7 of 18 members believe a rate hike might be appropriate sometime in 2022, up from four in March. While Chairman Powell suggested the median dot plot should not be viewed as a definitive path forward to short-term rates, it's clear the committee has shifted to a more hawkish stance, reflecting its more optimistic outlook on the economy.

Interestingly, when asked about the timing of the reduction in asset purchases, Chairmen Powell shied away from providing new details, but did say the committee was discussing tapering. Indeed, taking the committee's interest rate forecast and economic projections together, it seems tapering would be appropriate in 2022, especially given rate hikes are now expected in 2023. We now expect the committee will lay out its tapering plans at the September meeting.

The committee's more optimistic view on economic growth and inflation this year should prompt a reduction in asset purchases next year, followed by rate hikes in 2023. Yields across the curve jumped on the news as the Fed pulled forward its expectations of rate hikes. Equity markets slumped initially, although recovered shortly thereafter. We continue to expect yields will grind higher through the end of the year and strong economic growth accompanied by still relatively accommodative monetary policy will provide support to equity markets.

FOMC June 2021 Forecasts*

Percent

	2021	2022	2023	Long Run
Change in real GDP, Q4 to Q4	7.0	**3.3**	2.4	**1.8**
March Forecast	6.5	3.3	2.2	1.8
Unemployment Rate, Q4	**4.5**	3.8	**3.5**	**4.0**
March Forecast	4.5	3.9	3.5	4.0
PCE Inflation, Q4 to Q4	3.4	2.1	2.2	**2.0**
March Forecast	2.4	2.0	2.1	2.0
Federal Funds Rate, end of year	**0.1**	**0.1**	0.6	**2.5**
March Forecast	0.1	0.1	0.1	2.5

Source: Federal Reserve, J.P. Morgan Asset Management. Data are as of June 16, 2021.

*Forecasts of 18 FOMC participations, median estimate.

**Green denotes an adjustment higher, red denotes an adjustment lower.

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