First Trust ECONOMIC RESEARCH REPORT

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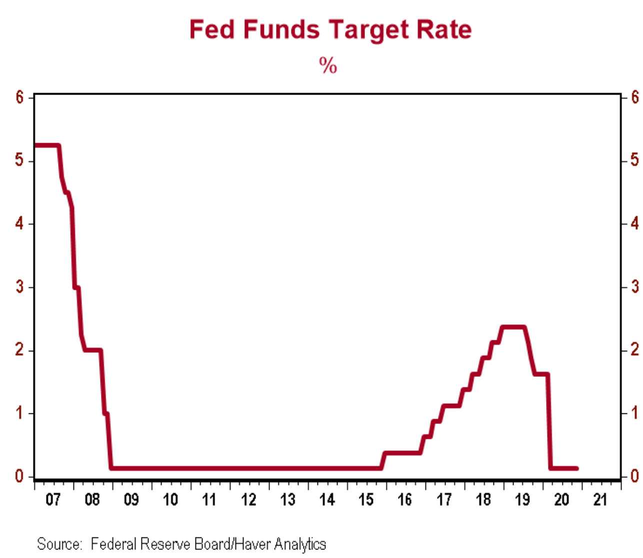
December 16th, 2020 • 630.517.7756 • www.ftportfolios.com

Eyes on the Horizon

Nobody expected to see a rate change from this week's FOMC meetings, but interest remained high as the market awaited the latest Fed forecasts on where they see the US economy headed from here. And the updates to the Fed outlook were notable. GDP and inflation projections were revised higher, while the unemployment rate forecasts moved lower, all signaling a stronger economic recovery than the Fed believed possible earlier this year.

How far have their forecasts come? Back in June, the Fed forecast the US economy would see a decline of 6.5% in real GDP in 2020, now they are targeting a decline of 2.4%. The year-end unemployment rate was projected at 9.3% back in June, but is now seen at (the current level of) 6.7% And future year outlooks have improved of late as well, both for economic growth and unemployment, which is now forecast to fall to 5.0% in 2021 and move below 4.0% in 2023. You may be tempted to think that the improved outlook may change the Fed's path for interest rates into the future, but that is the one area in today's report that remained unchanged.



The Federal Reserve has no plans to move rates in 2021, 2022, or 2023 (which is as far out as they forecast in their projection materials). Only one of seventeen voting members believes any change in rates would be appropriate in 2022, while five believe that rates could move higher in 2023. During Chair Powell's press conference, the question arose about supply chain disruptions and the upward pressure those may put on inflation as the economy gets back to normal over the next twelve months, and while Powell acknowledged that may indeed lead to a pickup in prices, the question for the Fed is if those rising prices will be persistent. The Fed is basically saying, "We won't believe it until we've seen it…for a while." In other words, the Fed believes inflation will be transitory and won't force its hand on a rate hike for at least the next few years.

Within the Fed Statement itself, the main notable change to the December release came from a clarification that the Fed plans to continue purchasing at least $80 billion per month of treasury securities and $40 billion per month of mortgage backed securities until "substantial further progress has been made toward the Committee's maximum employment and price stability goals." Again, the press conference brought additional light on this topic. The Fed believes (and we agree), that we still have a ways to go before the labor market has healed to where it was before COVID-19 reared its ugly head. Where we differ is in our belief that inflation will rise – and stay – above the Fed's target sooner and longer than it currently expects. That, in turn, would lead the Fed to raise rates before their post-2023 estimation. In the meantime, artificially low interest rates are a boon for stocks, which we believe remain undervalued, and poised for continued growth in the years ahead.

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Text of the Federal Reserve's Statement:

The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.

The COVID-19 pandemic is causing tremendous human and economic hardship across the United States and around the world. Economic activity and employment have continued to recover but remain well below their levels at the beginning of the year. Weaker demand and earlier declines in oil prices have been holding down consumer price inflation. Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

The path of the economy will depend significantly on the course of the virus. The ongoing public health crisis will continue to weigh on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent *over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, the Federal Reserve will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward the Committee's maximum employment and price stability goals. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.*

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Patrick Harker; Robert S. Kaplan; Neel Kashkari; Loretta J. Mester; and Randal K. Quarles.