

Fed Monitor

Fed considers introducing a temporary asymmetric operational inflation target range

In this new publication we will give regular updates on recent Fed communications, policy signals and economic indicators. The publication includes one page of text and a few pages with relevant tables and charts. Any input on the format is much appreciated – feel free to reach out to me using my contact information in the lower right corner.

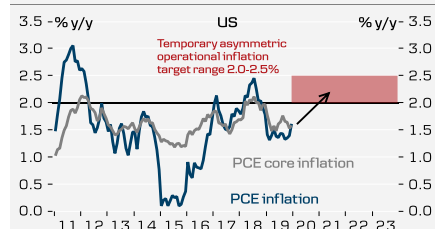
3 key takeaways from FOMC minutes

- **With respect to policy signals we did not learn much new**, which also makes sense given the many Fed speeches recently. **Consensus among FOMC members is that ‘the current stance of monetary policy is appropriate’** and that the Fed wants to see how the economy reacts to the three insurance cuts last year. **The Fed thinks the coronavirus is a new downside risk to the economy but so far it is monitoring the development, not reacting to it**, as we argued in *Fed Monitor: Monitoring, not reacting to, the coronavirus*, 12 February.
- **On the upcoming monetary policy review, the Fed still aims to complete the review around the middle of the year, i.e. a decision could come in the second half of the year, perhaps already in September.** The FOMC members had a long discussion about how to tweak the current symmetric 2% inflation target. While most participants ‘expressed concerns’ about introducing a permanent inflation target range around 2%, as it could be misperceived as the Fed being comfortable with continued misses below 2%, **the FOMC members still seem to prefer the idea of some sort of average inflation targeting. At the meeting, the FOMC members discussed the idea of an (temporary) asymmetric operational range with 2% being at or near the lower end of the range.** This would signal to market participants that the Fed can tolerate inflation above 2% for some time without raising rates. The Fed thinks this may help signalling that it intends to keep inflation at 2% on average over time, which may help anchoring longer-run inflation expectations. In one of the charts to the right, we sketch how that may look in practice. **Our base case is still that the Fed implements some sort of average inflation targeting this year, the question is the exact formulation of it.**
- **The Fed is still seriously considering implementing a standing repo facility** to make sure overnight rates do not surge again like last year. According to the minutes, ‘several participants suggested that the Committee should resume before long its discussions of the role that repo operations might play in an ample-reserve regime including the possible creation of a standing repo facility’. We continue to monitor the discussions in upcoming speeches/meetings. **With respect to the level of reserves, the Fed is still aiming at approximately USD1,500bn.** This level is expected to be reached before April.

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Illustration: what a temporary asymmetric operational inflation target range 2.0-2.5% may look like



Source: BEA, Macrobond Financial, Danske Bank
Illustration based on FOMC minutes from the meeting January 2020

US inflation expectations are low



Note: Past performance is not a reliable indicator of current or future results.

Source: Bloomberg, Federal Reserve, Macrobond Financial, Danske Bank

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Fed charts

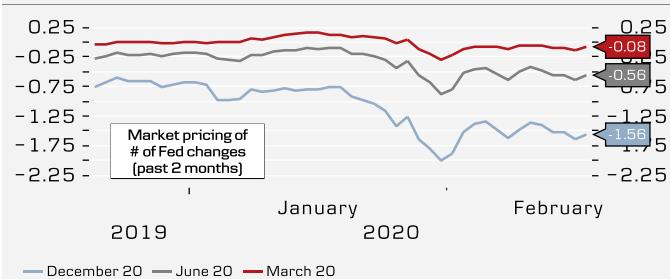
Recent Fed quotes

2020		Recent quotes
Hawkish	George Kansas city	Coronavirus global impact to hard to determine now
	Rosengren Boston	
	Mester Cleveland	
Neutral	Harker Philadelphia	"Too early to say what impact the coronavirus will have on the global economy"
	Barkin Richmond	Coronavirus makes it very difficult to do forecasting
	Quarles Board	
	Bowman (B) Board	Coronavirus "is a wild card"; "looking into how it translates into the outlook"
	Bostic Atlanta	"I expect China to have a couple of quarters of weaker growth and then bounce back"
	Clarida (B) Vice Chair	
	Williams New York	"Closely monitoring the coronavirus"; "it is too early to say"
	Daly San Francisco	
	Evans Chicago	"Coronavirus is yet another wild card, too soon to tell"
	Powell (B) Fed Chair	
	Brainard (B) Board	
Kaplan Dallas		
Dovish	Kashkari Minneapolis	Coronavirus "clearly is a downside risk for China"; "could affect" monetary policy
	Bullard St. Louis	Coronavirus is a "tail risk"
	Vacant Board	
	Vacant Board	

Voting member (B) Board Member

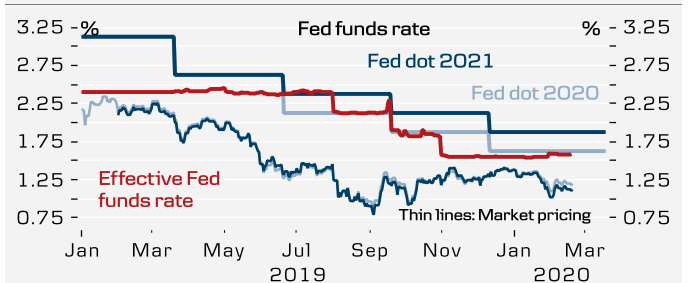
Source: Federal Reserve, Bloomberg, Danske Bank

Fed market pricing is now nearly 60% probability of a cut by June



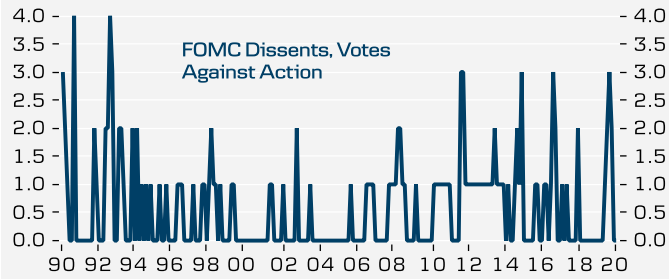
Note: Past performance is not a reliable indicator of current or future results.
Source: Federal Reserve, Bloomberg, Macrobond Financial, Danske Bank calculations

Fed dot suggests rate hikes further out, while markets are pricing cuts



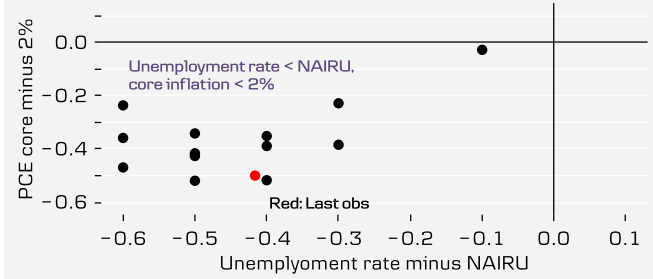
Note: Past performance is not a reliable indicator of current or future results.
Source: Federal Reserve, Bloomberg, Macrobond Financial, Danske Bank

Fed prefers to work by consensus



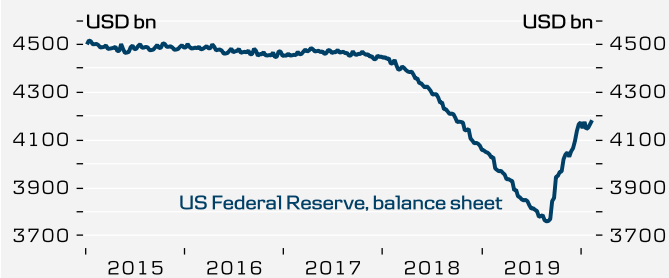
Source: St Louis Fed, Macrobond Financial, Danske Bank

Fed thinks it has fulfilled its maximum employment objective but inflation remains below 2%



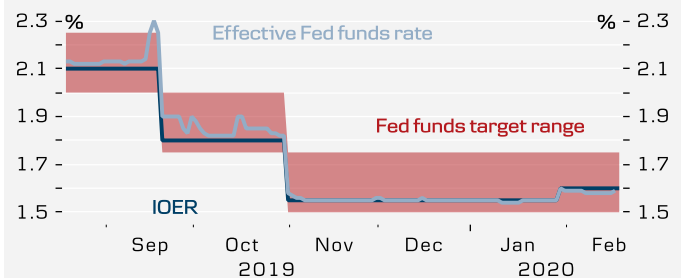
Source: Federal Reserve, BEA, BLS, Macrobond Financial, Danske Bank

Balance sheet is increasing



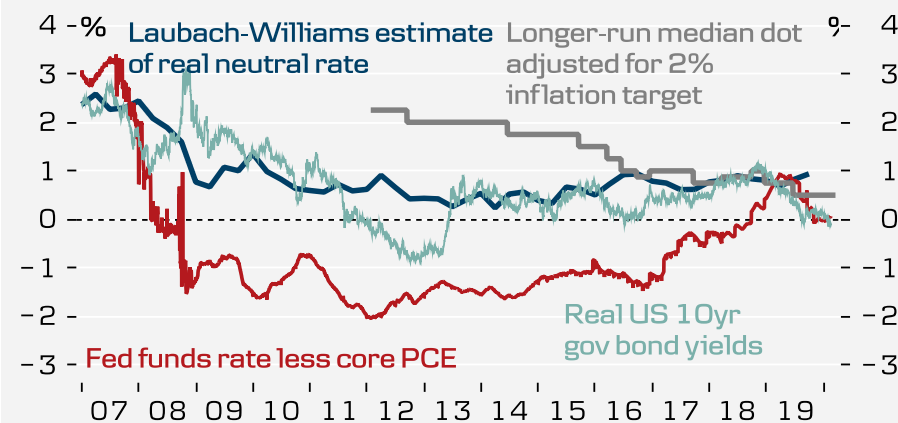
Source: Federal Reserve, Macrobond Financial, Danske Bank

Effective Fed funds rate has moved higher but remains below IOER



Note: Past performance is not a reliable indicator of current or future results. Source: Federal Reserve, Macrobond Financial, Danske Bank

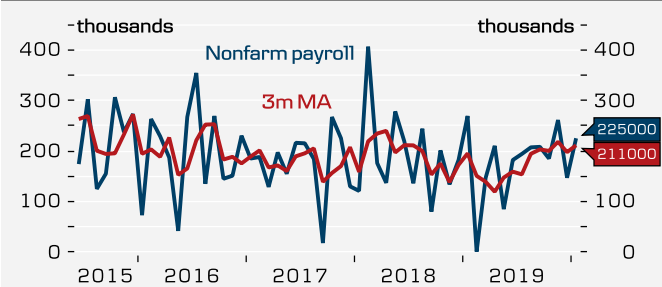
US monetary policy is not accommodative compared to market rates



Note: Past performance is not a reliable indicator of current or future results. Source: Federal Reserve, Bloomberg, NYFed, BEA, Macrobond Financial, Danske Bank

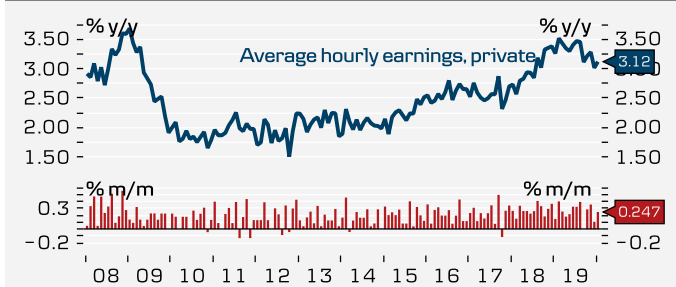
Macro charts

Employment growth is solid



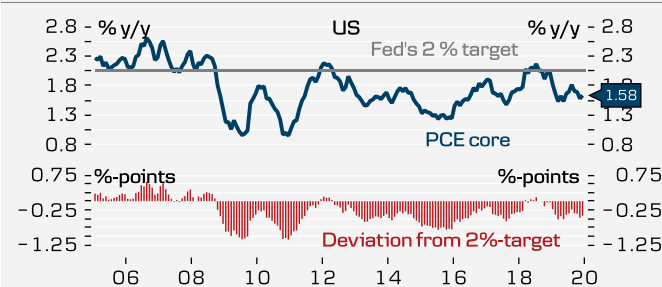
Source: BLS, Macrobond Financial, Danske Bank

Wage growth is not as high as previously but still decent



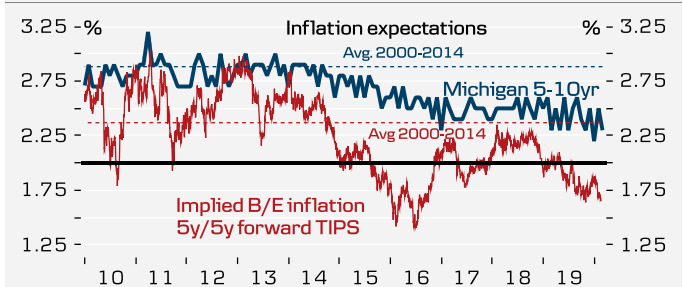
Source: BLS, Macrobond Financial, Danske Bank

PCE core inflation continues to run below the 2% target



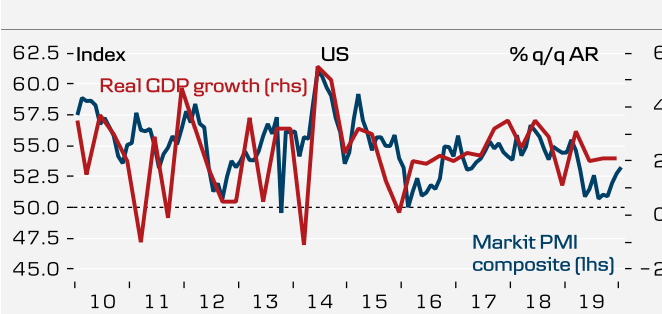
Source: BEA, Macrobond Financial, Danske Bank

Inflation expectations remain below historical average



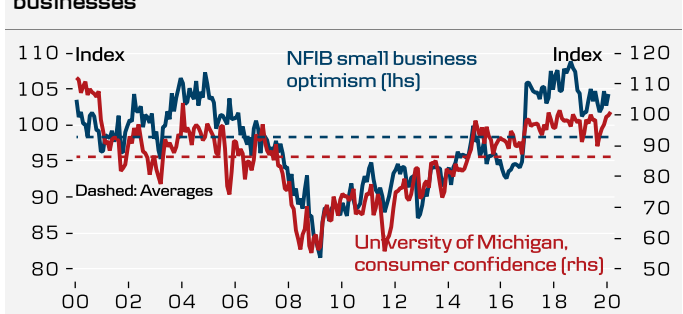
Source: Michigan, Bloomberg, Macrobond Financial, Danske Bank

Markit PMI has rebounded, signalling growth close to 2%



Source: BEA, IHS Markit, Macrobond Financial, Danske Bank

Optimism remains high among consumers and small businesses



Source: NFIB, University of Michigan, Macrobond Financial, Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Mikael Olai Milhøj, Senior Analyst.

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Ad hoc.

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