

Special Commentary — March 17, 2021

FOMC Keeps Policy Unchanged, but Rate Hikes Inching Closer More Members See Rate Hikes in 2022 and 2023

Summary

As widely expected, the Federal Open Market Committee (FOMC) refrained from making any major policy changes at its meeting today. But, the Committee upgraded its assessment of the current state of the economy. Specifically, the FOMC now looks for stronger GDP growth, higher inflation and lower unemployment in 2021 than it did three months ago. Although most FOMC participants continue to believe that it will be appropriate to keep rates on hold through 2023, a few committee members look for rate hikes next year and in 2023. The Committee made no changes to the interest rate that the Federal Reserve pays to commercial banks on the reserves that they hold at the central bank.

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FOMC Upgrades Its Assessment of the Economy

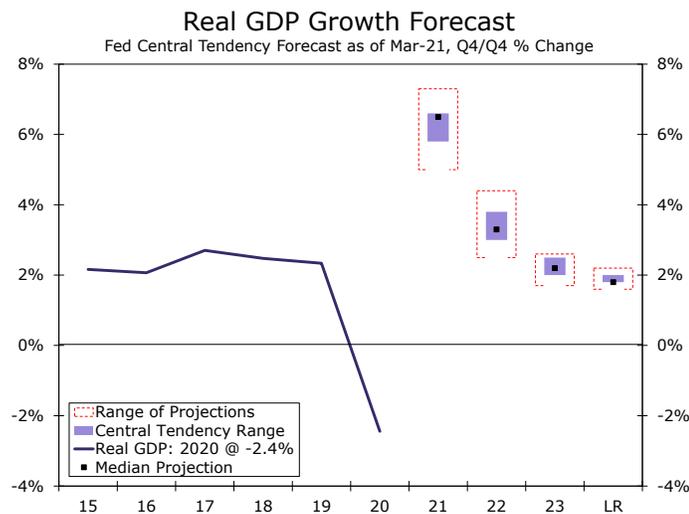
As widely expected, the Federal Open Market Committee (FOMC) refrained from making any major policy changes at its meeting today. Specifically, the Committee decided to maintain its target range for the fed funds rate between 0.00% and 0.25% and to keep the Fed's monthly purchase rate for Treasury securities and mortgage-backed securities unchanged at \$80 billion and \$40 billion, respectively. The Federal Reserve will continue to purchase securities at "at least" these rates "until substantial further progress has been made toward the Committee's maximum employment and price stability goals." The 11 voting members of the Committee voted unanimously to maintain the Fed's current policy settings.

Major policy settings kept on hold, although the Committee is more optimistic about the outlook.

That said, the Committee upgraded its assessment of the current state of the economy. The FOMC said in its January 27 statement that "the pace of the recovery in economic activity and unemployment has moderated in recent months." Today's statement said that "following a moderation in the pace of the recovery, indicators of economic activity and employment have turned up recently." But, the Committee did note that "sectors most adversely affected by the pandemic remain weak."

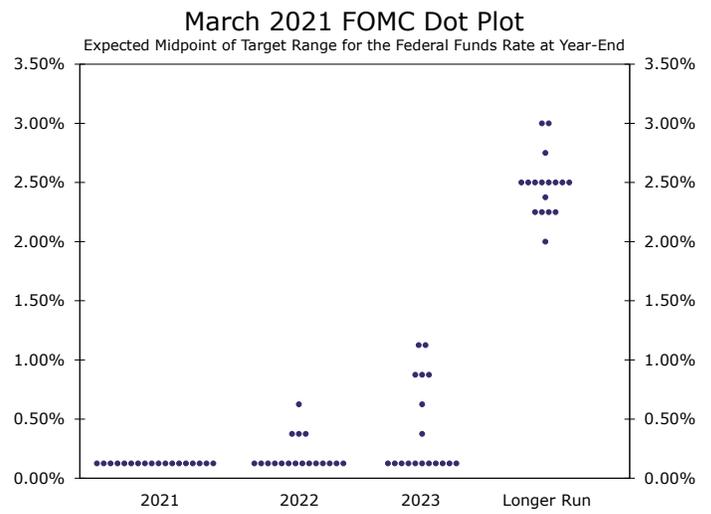
The Committee's more optimistic outlook for the economy was reflected in its quarterly Summary of Economic Projections (SEP), which summarizes the FOMC's forecasts. The median GDP forecast among the 18 committee members for 2021 rose to 6.5% in the current SEP from 4.2% in the last SEP (December) (Figure 1). The forecast for 2022 edged up to 3.3% from 3.2% previously. The upward revision to GDP growth led to a downward revision in the unemployment rate. Specifically, the median projection now shows the unemployment rate ending 2021 at 4.5%. This forecast had been 5.0% in December. Inflation, as measured by the year-over-year change in the PCE deflator, is forecast to end the current year at 2.4%, up from the 1.8% rate that was forecast in December.

Figure 1



Source: Federal Reserve Board and Wells Fargo Securities

Figure 2



Source: Federal Reserve Board and Wells Fargo Securities

Are Rate Hikes Coming?

The updated economic outlook led a few committee members to bring forward their expected timing of rate hikes, which was reflected in the so-called "dot plot." In December, only one of the 17 committee members thought that a rate hike would be appropriate. The dot plot released today now shows that four of the 18 members believe that a rate hike would be appropriate next year (Figure 2). Seven members think that rates will be higher in 2023, up from five FOMC members in December. We stress that the majority of FOMC members still believe that it would be appropriate to keep rates on hold through 2023. Indeed, we continue to forecast that the FOMC will keep rates on hold through at least the end of 2022, when our forecast period currently ends. But, the dot plot could drift higher in coming quarters if incoming data lead committee members to upgrade their forecasts for 2022.

Dot plot drifts higher.

No Technical Changes to IOER at this Meeting

The FOMC also decided to maintain the so-called Interest on Excess Reserves rate (IOER), which is the interest rate that the Federal Reserve pays to commercial banks on the reserves that they hold at the nation's central bank, at 0.10%. As we wrote in a recent [report](#), short-term interest rates have been drifting down toward 0.00% recently due to all the liquidity that is sloshing around the financial system. Therefore, we thought the committee may have nudged up the rate to 0.15% at this meeting, which would have incentivized commercial banks to leave more of their excess liquidity parked at the Fed. Although the FOMC decided to maintain IOER at 0.10% at this meeting, we expect the committee would to tweak the rate higher at a future meeting if short-term interest rates continue to linger at 0.00%. We should note, however, that any upward adjustment to IOER should be viewed solely as a technical tweak that is intended to give the Fed better control over short-term interest rate. An upward adjustment to IOER, should it occur, should not be interpreted as a signal of imminent monetary tightening.

FOMC maintains IOER at 0.10%.

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