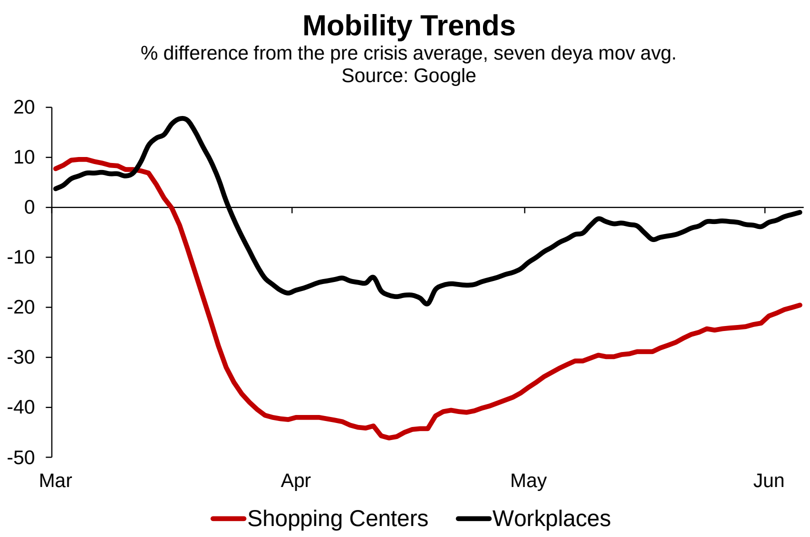
GIAM Macro & Market Research- Market Commentary

The Fed is in "wait and see" mode, but keeps the door open to additional measures.

- **The Fed expects quite a strong rebound, but the severe disruption caused by COVID will require rates to remain at near zero until 2022. The unemployment rate will remain high for long.**
- **The May employment report was a pleasant surprise, but also an indication on how unpredictable is the outlook. This warrants waiting and learning from new data before adapting the stance.**
- **Anyway, Chair Powel renewed the commitment to use aggressively all the existing tools; bond purchases will continue at least at the current pace. Further instruments, like yield curve control are being discussed.**

As widely expected the FOMC does not foresee any rate increase before end-2022, or using Chair Powel words: *"We are not thinking about raising rates. We are not even thinking about thinking about raising rates"*.

The improvement in economic and financial market conditions since the April 29 meeting is acknowledged, with activity several sectors already back to the pre-crisis level. The May employment report was cited as a positive surprise, which however underscores how big is the uncertainty on the direction on the economy going forward and the need the FOMC has to learn from data how the recovery unfolds. The fact that the burden of the crisis is falling on low skilled workers, women and minority has been underlined, in comparison with the good labour market outcome achieved for these categories before the COVID outbreak.

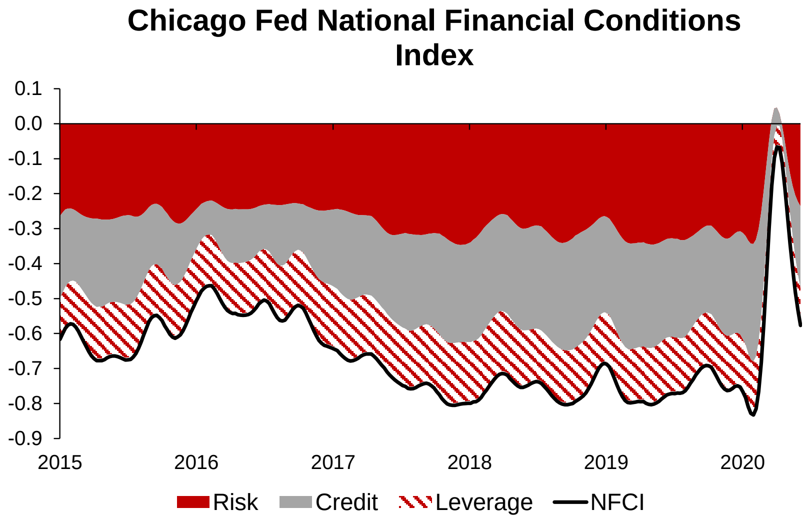


The economic projections show a contraction in 2020 GDP in line with consensus, followed by a rather sharp pickup. Unemployment rate is expected to end 2020 at 9.3%, but will stay elevated in the medium term. In the press conference Chair Powell repeatedly stressed that getting people back to work is the overarching priority; the Fed implicitly aims at returning to a below 4% unemployment rate which, Powell recalled, was achieved without any significant inflationary pressure. Indeed the projections show inflation remaining below 1% this year. It will not reach the 2% target before the end of 2022.

Interestingly the Fed does not expect the crisis to affect nether trend growth nor the structural unemployment rate. It appears confident that the measures taken can avoid permanent damages to the economy but, as Chair Powel admitted in the press conference, it is too early to assess the long-term effects of the outbreak. The expected long-term value for the policy rate is therefore unchanged at 2.5%.

	2020	**2021**	**2022**	**Longer run**
Change in real GDP	-6.5	5.0	3.5	1.8
Dec. projections	*2.0*	*1.9*	*1.8*	*1.9*
Unemployment rate	9.3	6.5	5.5	4.1
Dec. projections	*3.5*	*3.6*	*3.7*	*4.1*
PCE inflation	0.8	1.6	1.7	2.0
Dec. projections	*1.9*	*2.0*	*2.0*	*2.0*
Core PCE inflation	1.0	1.5	1.7	
Dec. projections	*1.9*	*2.0*	*2.0*	
Appropriate policy path				
Federal funds rate	0.1	0.1	0.1	2.5
Dec. projections	*1.9*	*2.1*	*2.4*	*2.5*

The press release contains few changes from April; it acknowledges that the economy has bottomed out and underlines the role of the quick monetary policy action is having in mitigating financial stress.



In terms of policy stance, there were no big changes; the Fed will strive to limit the long lasting damages to the labour market and production capacity. Rates will remain near zero until the Fed is confident in the strength of the recovery, but no explicit target for GDP or unemployment was mentioned. The large-scale bond purchases needed to keep the market running have been scaled back but from now on will continue at least at the current pace. Additional measures are being analysed: in particular, FOMC members are weighting the benefits and drawbacks of yield curve control, looking at the international experience. Yet a better knowledge of the state of the economy and the impact of the existing measure is needed before reaching a conclusion. The same applies to strengthening forward guidance on asset purchases. More details are likely in the July and September meetings.

As in past meetings, Chair Powell recalled that the Fed has just lending powers, and it is up to the congress to decide whether to provide further fiscal support. The GDP projections assume only a mild increase in the fiscal stimulus.

Chair Powell refrained from commenting on the impact of the Fed's action on financial markets, recalling that the FOMC is firstly concerned with the real economy. It looks at broad financial conditions but does not target any specific asset price. Risks to financial stability appear low thanks the healthy state of the banking sector in terms of capitalisation, liquidity and risk management practice. A further loosening in prudential regulation may be warranted to support lending.

Variable	Previous FOMC meeting	Latest	Chg. Since Prev. Meeting
Real Activity			
GDP (% qoq, ann.)	2.1	-5.0	-7.2
Chicago Fed Coinc. Ind.	0.1	-5.0	-5.02
ISM - Manuf	50.1	41.5	-8.6
ISM - Services	57.3	41.8	-15.5
Macro Surprises	-103.7	69.6	173.3
Labor Market			
Payroll growth (3 mth. MA)	-302	-6517	-6215
Unemp. Rate	3.5	13.3	9.8
Unemp. Rate (broad)	7.0	21.2	14.2
Hourly wages, % yoy (3 m. MA)	3.3	6.0	2.7
Prices			
Core CPI	2.4	1.2	-1.2
Core PCE	1.8	1.0	-0.8
Trimmed PCE	2.1	1.9	-0.2
U. Mich 5 yr exp.	2.3	2.7	0.4
NY Fed 3 Y exp.	2.4	2.6	0.2
5Y5Y fwd exp.	1.5	1.5	0.0
Financial Conditions			
Chicago Fed index*	-0.18	-0.58	-0.39
10 yr. Treasury	0.65	0.83	0.17
- Risk neutral Component	1.61	1.54	-0.07
- Term Premium	-0.95	-0.71	0.24
Yield curve (10Y - 2Y)	0.43	0.62	0.19
S&P 500	2878.5	3207.2	11.4%
Trade Wighted Dollar	130.9	125.8	-3.9%
WTI Crude Oil	12.8	38.9	204.7%
* Decrease: looser conditions			

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