Quiet Year Ahead

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The first Federal Reserve statement of the new decade proved one of the most uneventful in years, with virtually no change from the December outlook that suggested rates will stand pat in the year ahead. In fact – other than the changes in the names of voting members who rotate each year, and noting the month of the last meeting – there were only two words changed between the December statement and today's.

The first text change came in noting that household spending has been rising at a "moderate" pace, a slight downgrade from December's "strong" pace. The second change relates to inflation, which the Fed now sees "returning to" the 2% target, while the prior statement said inflation was "near" the target. Does either change to the language suggest a shift in the Fed outlook? No.

The Fed did make one technical adjustment related to the operation of rate setting, with the Fed moving interest paid on excess reserves (IOER) to 1.60%, up from 1.55%. In his press conference, Powell noted that this was a reaction to reduced volatility in repurchase (repo) rates following the Fed reinstatement of a standing repo facility (more on that in this week's MMO). The Fed feels more comfortable with the management of interest rates, and is simply reversing an adjustment made in September when volatility picked up. Along similar lines, Powell suggested that the Fed expects to see excess reserves in the system hover around $1.5 trillion, roughly in-line with current levels.

As expected, a question arose from the media related to the coronavirus, which Powell noted that the Fed will continue to monitor for impacts both domestically and globally. While there will likely be near-term impacts on output, particularly in China, other signs from global economies have the Fed "cautiously optimistic" that growth is returning higher.

Looking forward, we think the Fed will stand pat through 2020, just like it says, which means monetary policy will not at all be an impediment to economic growth. The M2 measure of the money supply has accelerated in the last year and we expect this to translate into faster inflation in the year ahead as well as faster growth in nominal GDP (real GDP growth plus inflation).

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