Fierce Fed Action

"We're not thinking about raising rates. We're not even thinking about thinking about raising rates," Fed Chairman Jerome Powell said. "What we're thinking about is providing support for the economy. We think this is going to take some time."

That was evident from the Fed's updated set of projections for the economy, its first since December after they skipped the planned March iteration because of the high level of uncertainty at the time. The Fed noted they expect the economy to contract 6.5% in 2020 before rebounding 5.0% in 2021 and 3.5% in 2022, with long-run potential growth of 1.8%. Compared with the pre-pandemic 3.5% rate and longer-run neutral estimate of 4.1%, unemployment is now expected to end 2020 at 9.3%, end 2021 at 6.5%, and end 2022 at 5.5%. Core inflation is expected to stay muted, only rising to 1.7% over the projected time frame.

Powell said the economic projections were made with the "general expectation of an economic recovery beginning in the second half of this year and lasting over the next couple of years, supported by interest rates that remain at their current level near zero. Powell also stressed that the pace of the recovery is dependent on the path of the coronavirus.

The Fed also plans to continue increasing its bond holdings, targeting Treasury purchases at $80 billion a month and mortgage-backed securities at $40 billion.

Investors had been watching the statement for how accommodative the Fed would continue to keep policy. The bond purchases were seen as critical given that the Fed has scaled back its purchases sharply. The buying went from a peak of $300 billion a month in Treasuries during the early days of the coronavirus crisis to $20 billion a week more recently.

In a separate statement, the Fed said it would maintain purchases "at least at the current pace to sustain the smooth functioning of markets for these securities, thereby fostering effective transmission of monetary policy to broader financial conditions."

Even with the deceleration, though, the Fed's balance sheet has exploded to more than $7.2 trillion.

Fed officials sent a clear message yesterday: the economic damage from the pandemic has been significant and it will likely take years to recover. There will be a significant amount of labor slack through 2022 and interest rates will be anchored near-zero for the foreseeable future. While the Fed's support and backstop has been absolutely necessary and is crucial to the economic and market recovery, Powell doused some cold water on the theory that the worst of the crisis is over with the reopening underway. In fact, Powell seemed to go out of his way to project skepticism about a "V" shaped recovery, while at the same time demonstrating an absolute commitment to using the full force of the Federal Reserve's arsenal to support a recovery. As markets digest this stance, stocks have pared back some of their earlier week euphoria. We expect this back-and-forth to continue until the markets have some fundamentals to hang onto, and that may kick off in July with the second quarter earnings season.

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