MIRABAUD
Asset Management

FLASH NOTE — FOMC Meeting June 2020


For Professional Investors Only

# FED FAR FROM DONE, UNDETERRED BY STRONG MAY JOBS DATA

STRATEGY TEAM

- In its June policy meeting, the US central bank reaffirmed its commitment to support the labour market, sending an overall dovish monetary policy message.
- By suggesting that policy rates will remain near zero during the next two years, while stressing the significance of the downturn, the Federal Open Market Committee signals that it stands ready to keep monetary policy accommodative.
- We expect the Federal Reserve to keep its current pace of asset purchase in place for a long time, with interest rates anchored near zero.

**Bleak on the economy, generous on policy stimulus—**this Is the main message from the latest US Federal Reserve policy meeting this week.

First, the US central bank's Federal Open Market Committee (FOMC) remains notably pessimistic on the economy. By predicting an economic contraction of 6.5% this year, followed by a recovery of a mere 5% next year, the internal outlook of the US central bank is bleak. The International Monetary Fund, for instance, expects the contraction of the US economy this year to be less pronounced, while also forecasting a more dynamic recovery in 2021, where US GDP is expected to grow by nearly 6%, a near full percentage point higher than the economic projections by the Federal Reserve (Fed).

Second, we note that the Fed does not believe that the current crisis will severely damage US long term growth or other key macroeconomic variables. For instance, only "longer run" growth is revised slightly downward (to 1.8%, -0.1ppt), while the 'equilibrium' unemployment and inflation rate were both kept unchanged. Also, the Fed sees inflation — headline and core personal consumption expenditures (PCE) index, the Fed's most favorite inflation gauge — to reach only 1.7% by 2022 — notably unambitious. Given the current disinflationary impact of the downturn, we believe that this target, under current circumstances, will be difficult to meet.

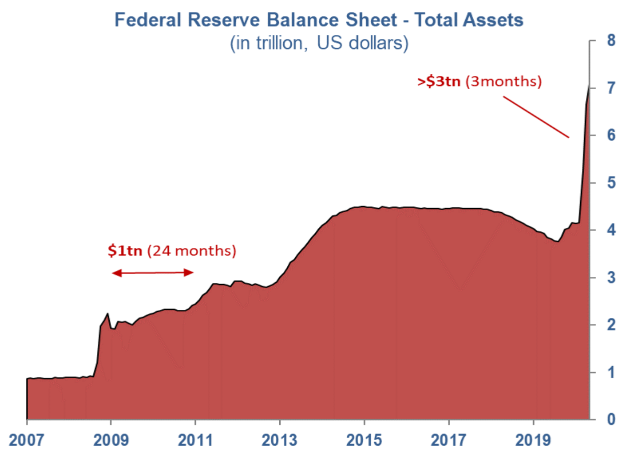
In the shorter term, by predicting an inflation rate below 1% this year and an unemployment rate of more than 9%, the challenges remain huge.

**Further announcements** include the intention to increase its US Treasury and Mortgage-Backed Securities holdings ($80bn and $50bn, net) "at least at the current pace" over coming months. Possible future policies which include yield curve control remain "an open question", according to Fed Chair Powell, while no further hints on negative rates were given.

**Our main take** is that given the pessimistic forecasts by the Federal Reserve itself, with key indicators expected to be far off objectives, the Federal Reserve will keep its very generous monetary policy in place for a long time, with a bias to do even more.

**Implications for asset allocation**. Recent decisions are in line with our main convictions. Those include prudence on US equities following the recent rally—we keep our underweight exposure. In fixed income, we continue to favor higher duration bonds in the US Treasury market. Finally, with interest rates remaining near zero for a long time, and asset purchases by global central banks to continue, we remain overweight in gold.

### FED TO CONTINUE ITS BALANCE SHEET EXPANSION




Sources: Federal Reserve System, Bloomberg, Mirabaud Asset Management

### ECONOMIC PROJECTIONS: THE OUTLOOK IS BLEAK, FED SAYS

| FOMC Staff Projections [June 2020] | 2020 | 2021 | 2022 |
|---|---|---|---|
| **GDP Growth** [Real] | **-6.5%** | **5.0%** | **3.5%** |
| *December 2019* | *2.0%* | *1.9%* | *1.8%* |
| **Inflation** [PCE] | **0.8%** | **1.6%** | **1.7%** |
| *December 2019* | *1.9%* | *2.0%* | *2.0%* |
| **Unemployment Rate** | **9.3%** | **6.5%** | **5.5%** |
| *December 2019* | 3.5% | 3.6% | 3.7% |

Sources: FOMC, Mirabaud Asset Management