MARKET INSIGHTS

Market Bulletin

December 11, 2019

Strongly neutral

As anticipated, the Federal Reserve (Fed) maintained the current Federal funds target rate at a range of 1.50%-1.75%. The decision was unanimous, with all ten voting members electing to leave rates unchanged. The language in the Federal Open Market Committee (FOMC) statement was neutral, citing that the Committee feels like "the current stance of monetary policy is appropriate to support sustained expansion of economic activity," suggesting it intends to remain on pause over the medium term. The Committee did acknowledge that muted inflationary pressures and global developments—a nod to ongoing trade tensions—will be closely monitored going forward.

The Committee also released new quarterly economic projections, which struck a slightly more optimistic tone on the health of the economy. Relative to its September estimates, no changes were made to economic growth and headline inflation estimates, and the unemployment rate projection was nudged lower by 0.2% in both 2020 and 2021 to 3.5% and 3.6% respectively, highlighting continued robustness in the labor market, yet still subdued inflation.

FOMC December 2019 Forecasts*

Percent

	2019	2020	2021	2022	Long Run
Change in real GDP, Q4 to Q4	2.2	2.0	1.9	1.8	1.9
September Forecast	2.2	2.0	1.9	1.8	1.9
Unemployment Rate, Q4	3.6	3.5	3.6	3.7	4.1
September Forecast	3.7	3.7	3.8	3.9	4.2
PCE Inflation, Q4 to Q4	1.5	1.9	2.0	2.0	2.0
September Forecast	1.5	1.9	2.0	2.0	2.0
Federal Funds Rate, end of year	1.6	1.6	1.9	2.1	2.5
September Forecast	1.9	1.9	2.1	2.4	2.5

Source: Federal Reserve, J.P. Morgan Asset Management. Data as of December 11, 2019.

*Forecasts of 17 FOMC participations, median estimate.

**Green denotes an adjustment higher, red denotes an adjustment lower.

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The median federal funds rate projection, as measured by the "dot plot," was 1.625% for 2020, implying no future rate adjustments next year, and for just one hike in 2021. Notably, out of the 17 FOMC participants, only four members voted for just one hike next year with the rest voting for no further changes, suggesting the committee is in broad agreement of an "on-hold" approach to policy over the medium term. Importantly, as is customary, voting committee members will change at the first meeting in January 2020. Our analysis suggests the Committee may shift slightly more hawkish; however, it should be noted that this shift is unlikely to change the Fed's course of action, particularly in an election year in which it does not want to be overly politicized.

Elsewhere, during the press conference, Fed Chairman Jerome Powell acknowledged the active involvement of the Fed in the repo market given the recent spikes in short-term rates. For investors, spikes in repo rates are unlikely to have a dramatic effect on the broader macro economy, yet do erode the credibility of the Fed's ability to conduct monetary policy using an "ample reserves" framework. In turn, the Fed will increase T-bill purchases to assure ample liquidity is in the system through the middle of next year and conduct term repo operations through the end of this year. While the Fed professes independence, additional Treasury purchases allows the Federal Government to finance itself more cheaply given principal and interest payments to the Fed are returned to the Treasury.

Markets digested the news in stride with equity markets moving higher and bond yields relatively unchanged. For investors, the bar remains high for the Fed to adjust interest rates in either direction at least through 2020. Therefore, in the 11th year of an economic expansion with elevated valuations in both stocks and bonds, a balanced approach in portfolios seems appropriate.

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