Federal Open Market Committee Meeting
(16\textsuperscript{th} - 17\textsuperscript{th} March 2021)
Macroeconomic Research
CityU Research & Investment Club

Authors
AGALTSOV Timur
KHALIL Muaz

Published by CityU Research & Investment Club
# Table of Contents

Table of Contents ........................................................................................................................................... 1  
Executive Summary ........................................................................................................................................... 2  
FOMC Key Points Analysis ............................................................................................................................. 2  
  a) Inflation Rate........................................................................................................................................... 2  
  b) Interest Rates........................................................................................................................................... 2  
  c) Unemployment Rate ............................................................................................................................... 3  
Impact of the Meeting on the Economy (Short-term 2021) ........................................................................... 4  
Appendix ....................................................................................................................................................... 6
Executive Summary

On March 16-17, 2021, The Federal Reserve hosted an FOMC meeting, where the Committee members addressed their view on this year's monetary policy. The FOMC performs all open market operations, which includes the acts of selling and buying treasury securities to control the money supply, which as a result, affects the federal funds rate. In this meeting, the Chairman of the Federal Reserve Jerome Powell, alongside members of the Board of Governors, president of the Federal Reserve Bank of New York, and four other Reserve Bank presidents evaluated the current rate of economic recovery and the effects of the global pandemic on the economy in the short-term and medium-term.

Overall, the Fed continues to have a highly accommodative stance on monetary policy with an expected range for interest rates between 0 to 0.25% in 2021. The Federal Reserve has stated that they will maintain this policy until the labor market has displayed signs of achieving the Fed's maximum employment estimation and inflation rising above 2%. In the post-meeting press conference, Chairman Powell has explicitly stated that despite recovery progressing faster than expected, the Fed has to see more evidence from the economy to confirm that the employment rate is maximized, and average inflation is above 2% by the end of this year to make any changes in current monetary policy.

Despite that the forecasts for economic expansion have been upgraded from the December meeting, Powell remains cautious regarding changes in the current monetary policy as there is still a lot of uncertainty in the air. The upcoming FOMC meeting on 27-28 April 2021 will add some transparency on how exactly the economy is rebounding from the crisis this year and if the Fed will actively alter its current approach toward the "dual mandate".

FOMC Key Points Analysis

a) Inflation Rate

The pandemic has severely affected the demand side of the economy. The pandemic-induced recession has affected the market conditions severely. However, the recent developments of widespread vaccination and Biden's 1.9 trillion-dollar relief package have been catalysts for positive economic growth, especially on the demand side. Due to economic recovery from the pandemic, the increase in commodity prices also leads to cost-push inflation.

However, the present inflation rate is still below 2% (Core PCE), which is the Fed's long-term target rate of inflation. In the March FOMC's meeting, it was decided to allow inflation to rise over 2% in the short term, as a rising inflation rate would signal an economic recovery. The inflation rate is not the primary focus of the Feds currently, as they would be focusing more on bringing the unemployment rates down. There is still excess supply in the labour market. A decrease in the unemployment rate would be a cause for increasing inflation rates (Phillips curve). Since the pandemic's start, the inflation rate remained below 2%, while a short-term inflation rate is estimated to be slightly above 2%. These rates align with the Fed's goal of sustaining long-term inflation at around 2%, which is a good sign for stable economic growth in the next few years.

b) Interest Rates

The discussion regarding interest rates was one of the highlights of March's FOMC meeting. The anticipation in the market about the interest rates was the reason for significant movements in the stock market. Overall, investors were worried that interest rates would be rising sooner than was previously anticipated, mainly due to the strong economic rebound. A rise in interest rates is typically followed by a
decline in the stock market. The price of investment/borrowing for companies would go up, and the demand for stocks would go down, as people would prefer to earn interest on their savings rather than make investments.

In this FOMC, the Fed has decided to keep the interest rates on required and excess reserve balance, which is the amount charged by Fed Reserve Banks when they give overnight loans to depository institutions, at 0.1%. The Fed's short-term funding for depository institutions (primary credit rate) would be 0.25%.

The Federal Funds Rate, the amount depository institutions charge each other for overnight lending, would be kept between 0% and 0.25%. Banks tend to increase lending when they have excess reserves. The Fed's reserve requirement was previously lowered so that banks could lend out more to aid the economic recovery process by increasing the money supply in the economy. However, that bank-leverage exemption expired in March.

The Federal Funds Rate would be kept within this range until the labour market is back to the Fed's assessment of full employment and the inflation rates have risen above 2% consistently for some time. In the economic projections released by Fed, the Fed Fund Rate was forecasted to be at a median of 0.1% until 2023. However, with the economic recovery outpacing the initial projections, there is still some concern if the Fed would keep this target or reconsider it soon. A near-zero interest rate would be harmful if the economy starts to experience a positive output gap, which would be inflationary and might lead to the overheating of the economy.

**c) Unemployment Rate**

In this FOMC meeting, Chairman Powell has clearly indicated that in 2021, one of the major goals of the Federal Reserve remains to maximize the employment rate as the Fed expects a much rapid labor market recovery this year due to the vaccine distribution and government stimulus package.

The Fed's new estimation of the unemployment rate in 2021 has exceeded its December expectations, displaying a drop to 4.5% from the previous estimation of 5%. According to the Fed, this trend will continue in 2022 and 2023, with the unemployment rate falling to pre-COVID-19 levels of 3.9% and 3.5%, respectively. These expectations are a positive indicator of the economic recovery this year as well as in the next three years.

The Fed's approach on maximizing employment in the near future stresses its decisiveness to meet the "dual mandate". In the past century, the simultaneous maintenance of low inflation and low unemployment was proven to be possible, and the Fed has established this direction for the U.S. economy going forward. After the Great Depression, the country observed rapid economic expansion, which led to a lower unemployment rate compared to the previous estimation. However, despite analyst's concerns, the job market turned out to be tremendously flexible, and the price levels remained relatively stable, which is a second goal of the dual mandate, hence proving that two major goals of the Fed are attainable and can co-exist without severely affecting one another.

Overall, the Fed's objectives with regards to minimizing the unemployment rate in the short term could be achieved. The latest FOMC meeting has shown that people should expect a much faster economic recovery, and thousands of more jobs should be available. According to the Bureau of Labor Statistics (2021), there were 379,000 jobs added to the labor market in February, showing much optimism for the U.S. economy this year. With the current vaccine distribution, that number is projected to grow, which leaves the Fed confident about the economic recovery pace and the employment rate in the country in the next three years.
Impact of the Meeting on the Economy (Short-term 2021)

The recent FOMC projections gave a clear outlook for the economy in the short term. The economic rebound is expected to be stronger than previously anticipated. March's FOMC meeting gave optimism for the pandemic-hit global economy. The Fed has updated its forecasts about GDP growth, unemployment, and inflation.

The forecast for the change in real GDP of the U.S. in 2021 was increased from 4.2% to 6.5%. Most of this increase in real GDP could be attributed to Biden's 1.9 coronavirus trillion-dollar relief package. Coupled with the recent widespread vaccination drives in the U.S., the economy is expected to be reaching the pre-pandemic levels by 2021, much earlier than previously expected.
As for the unemployment rate and inflation, the two primary duties of the Fed, the short-term outlook is promising. The core inflation rate is expected to be about 2.2%, up from 1.8% (December 2020 Fed projections). The Fed has repeatedly assured the public that it is nothing to worry about. However, inflation is an alarming word in the eyes of the people and investors. Historically, inflation has contributed to the stagnant growth in the 1970s and 1980s, giving rise to the concept of "stagflation". According to Fed, they would welcome an inflation rate of over 2% for some time before considering raising the interest rates. A steady rise in inflation would be a clear indication of increased economic activity.

The unemployment rate for 2021 is expected to be around 4.5%. Interestingly, historical correlations show that the Non-Accelerating Inflation Rate of Unemployment is also about 4-5%, which means that a rise in inflation rates would accompany any further drop in unemployment.

Overall, this FOMC meeting has provided a positive outlook for the short-term future after gloomy spells due to the pandemic. The unemployment rate has gone down significantly. However, employment is still 9.5 million below its pre-pandemic levels. It would be riveting to see how the economy would perform in the rest of the year, given the resurgence of COVID cases in the U.S. in April and the emergence of mutant variants of COVID. Furthermore, stock markets are expected to be in a frenzy in April and May, with the investors looking out for any hints of increasing interest rates in the situation. The situation in the short term still raises a lot of concerns, and the Fed's April's FOMC might be able to quell the speculations of the sudden rise in interest rates.
Appendix

Appendix 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, March 2021

<table>
<thead>
<tr>
<th>Variable</th>
<th>Median 1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2021</td>
</tr>
<tr>
<td>Change in real GDP</td>
<td>6.5</td>
</tr>
<tr>
<td>December projection</td>
<td>4.2</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>4.5</td>
</tr>
<tr>
<td>December projection</td>
<td>5</td>
</tr>
<tr>
<td>Core PCE inflation</td>
<td>2.2</td>
</tr>
<tr>
<td>December projection</td>
<td>1.8</td>
</tr>
</tbody>
</table>

Source: Federal Open Market Committee

Appendix 2. Dot plot graph of Federal Funds Rate projections

Source: Bloomberg