Economic highlights from the week ending on June 18, 2021

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The Federal Open Market Committee (FOMC) kept monetary policy unchanged at its meeting this week. The fed funds target rate remains in the range of 0.0% to 0.25%, and the Fed continues to purchase $80 billion of Treasuries per month, and $40 billion of agency mortgage-backed securities per month. The FOMC raised the interest rate on excess bank reserves (IOER) and reverse repo rates by 5 basis points to 0.15% and 0.05%, respectively. We believe this move was primarily meant to improve money market functioning, relieve pressure on front-end rates, and prevent repo rates from falling below 0%, but do not see this as a sign of monetary tightening. The Fed has started to discuss the idea of reducing its asset purchases at some point, but that decision remains uncertain. FOMC members' updated economic projections also suggest that the Fed may start to raise interest rates in 2023, versus the previous estimate of 2024. Overall, monetary policy remains highly accommodative for now, but the Fed seems to be inching toward a path of policy normalization.

The FOMC's economic forecasts suggest they may be on track to reach their employment and inflation goals faster than previously expected. The Fed is now projecting 7.0% growth in gross domestic product this year (up from the previous forecast of 6.5%) and still expects the unemployment rate to decline to 4.5% by year-end. Although the Fed revised its inflation forecasts higher for 2021 (e.g., Core PCE of 3.0% this year versus the previous forecast of 2.2%), they expect inflationary pressures to moderate to 2.1% next year. The Fed continues to believe that many of the factors causing current inflationary pressures are likely to be temporary. According to the FOMC's dot plot, the majority of Fed policymakers are still forecasting no change to the fed funds target rate next year. However, looking out to 2023, the majority (13 out of 18) are now forecasting at least one 25 basis point rate hike. When the Fed released its dot plot three months ago, only 7 out of 18 members were forecasting a rate hike in 2023. What's more, the consensus forecast among policymakers now suggests that the fed funds target rate may increase by 50 basis points in 2023. Although the Fed does not specifically quantify its projections for asset purchases, it is widely assumed that the Fed would begin reducing its asset purchases well in advance of any rate hike. Overall, the projected timeline for when the Fed may begin normalizing monetary policy has been pulled forward. Nevertheless, we believe the Fed is likely to proceed with caution, given the ongoing level of uncertainty about the global pandemic, and will continue to assess economic data over the coming months before making any significant decisions about monetary policy. We anticipate the Fed will remain on the sidelines over the near-term, but we believe the probability that the Fed will begin tapering its asset purchases during the first half of next year has increased, assuming the US economic recovery remains on track.

Economic data was somewhat mixed this week. Housing starts and permits slowed down in May and retail sales were weaker than expected. Meanwhile, industrial production grew faster than expected in May but April was revised downward. Overall, we believe individual economic reports continue to be somewhat distorted by the pandemic, the uneven timing of fiscal support, and continued reopening of the economy. The

Conference Board's index of Leading Economic Indicators (LEI), which is a composite of forward-looking economic data, increased 1.3% in May, in line with expectations. Strength among the components was widespread, suggesting that economic growth will remain strong in the near-term.

Next Week

Chicago Fed National Activity Index, Existing Home Sales, New Home Sales, Durable Goods, GDP, Personal Income & Outlays, Consumer Sentiment

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