Fed Note from investment firm which I have access:

The Federal Reserve made no policy changes at today's meeting, as expected, keeping the fed funds rate at the zero bound of 0.00-0.25%. There were no dissents from committee members. The dollar swap lines and repurchase facility were also extended.

The formal statement was little changed, in terms of wording. The purchase of treasuries ($80 bil./mo.) and agency mortgages ($40 bil./mo.) will also continue until they make 'substantial progress' on their employment and inflation goals. There was initial speculation about the Fed potentially lengthening the average maturity of their treasury portfolio, in order to target the part of the yield curve most sensitive to consumer borrowing (and perhaps indirectly to keep U.S. borrowing rates contained), but this was not part of the official plan this month.

In the released summary of economic projections, GDP expectations were raised a bit for 2020, as well as for the next two years. The median unemployment rate was lowered, while expectations for inflation were raised a bit—all closer to trend pre-Covid. The 'dot plot' of fed funds rate expectations shows zero until at least 2022, with a few breakout opinions by 2023.

This is how the key Fed inputs are finishing the unusual 2020 year:

Economic growth: In keeping with the recovery starting in Q3 (annualized +33%, following the -31% drop in Q2), Q4 growth is expected to be in the ~5% range (although the Atlanta Fed's estimate remains above 10%). However, more robust earlier estimates have fallen after the recent wave of Covid infections and restrictions in several populous states. Following these waves, now that emergency vaccine use has been approved, the trajectory of expected 2021 growth is almost completely reliant on vaccine distribution and acceptance. The eventual recovery of the economy is not really in dispute—the matter of debate remains the timeframe and near-term impact of lockdowns causing further delay. The current consensus for 2020 is negative low-single-digit growth, perhaps slightly better than -5%, followed by mid-single-digit expansion in 2021, and a gradual resumption back toward 2-3% trend growth in the years following. Regardless of the vaccine rollout details, it may take a few years to fully get back to a pre-Covid 'normal' (the definition of which also remains in flux). A recovery that moves faster than this could pressure the Fed to normalize rates higher more quickly; ongoing sluggishness could be enough rationale for pegging rates at zero for years.

Inflation: Last week, November CPI was reported as 1.2% for headline and 1.7% for core, on a trailing 12-month basis. Despite the improvement in economic growth, inflation has lagged behind. The Fed's policy is targeted to this, and with little thus far to point to re-accelerating inflation, this indicator would push for rates staying accommodative for some time. They've indicated as much through their average inflation targeting policy, which is dovish in nature. Fears of future inflation brought on by the Fed and Congressional fiscal spending remain 'out there,' although it's assumed a divided House/Senate may help keep spending in better check. The long-term debate about inflation is split between these fears of a spike due to the long period of easy monetary policy and unprecedented spending, offset by demographic and technological forces pointing to a continued secular period of tempered price growth.

Employment: Job numbers have followed an expected path, with a sharp drawdown in the spring, and recovery over the summer and fall. Recent reports have seen a flattening trend, coinciding with the above-mentioned restrictions and unwinding of one-off impacts such as census workers. Reacceleration in key services sectors such as tourism, hotels, air travel, as well as retail and education, will be key to the timing of how quickly unemployment declines back to prior pre-Covid lows. Unfortunately, due to the structure of the labor force, this may take longer to normalize than will the economy overall.

Investment markets have embraced the news of several effective Covid vaccines, with November's equity performance ranking among the best single months over the past few decades, along with gains for commodities, and tighter spreads for corporate debt. Have they moved too far, too fast? That is always a question during times of positive or negative change. It is always about expectations. Just as markets can react to the worst consensus fears, they can also run in advance to the highest hopes. The reality often falls somewhere in the middle, as fundamentals catch up to sentiment (and valuations). With the Fed keeping rates low for an extended period, this input can result in somewhat higher warranted valuations—until rates rise again, that is, somewhere down the road.

Bond yields remain low across the board, from a historical perspective, on a nominal and after-inflation real basis. While there are some opinions that a faster recovery and changed Fed language could result in higher long-term rates and a steeper yield curve, the Fed has been careful about messaging during this sensitive period. It's hard to see this changing in the near-term.

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