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BREAKING NEWS
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Fed keeps its foot on the gas as the virus threatens the recovery

As expected, the Fed announced no new policy measures at its July meeting. However, it gently downgraded its verbal assessment of the U.S. economic outlook and hinted at changes to its approach to implementing and evaluating monetary policy in the future.

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WHAT HAPPENED?

The Federal Reserve's Open Market Committee (FOMC) made no major policy announcements at its July meeting. The statement released after the meeting noted the significant increase in new U.S. coronavirus cases since the June 10 meeting.

Since the Fed's last meeting, high-frequency data suggest that the U.S. economic recovery has begun to stall, particularly the previous robust recovery in the labor market. The most striking change to the Fed's statement from June was the addition of a single sentence: "The path of the economy will depend significantly on the course of the virus." The committee also mentioned that economic activity and employment have picked up "somewhat" but "remain well below their levels at the beginning of the year."

The Fed did not change its policy guidance, which still promises that monetary policy will remain unchanged from its current accommodative posture until the economy is back on track to full employment and 2% inflation.

A CAUTIOUS POWELL PRESSER

The Fed did not release new economic projections at this meeting, but Chairman Jerome Powell held a press conference at which he was asked more about the Fed's policy outlook and the importance of more stimulus to pair with the Fed's efforts.

Powell avoided providing specifics in response to questions about the stimulus debate in Congress, but he repeatedly emphasized positive effects of the original CARES Act passed back in March and professed a belief that more support will be needed. Several provisions of that bill have already expired or are about to, as negotiations are expected to last at least into next week.

A NEW FRAMEWORK COMING SOON?

Powell also briefly mentioned the Fed's ongoing monetary policy framework review, which will likely be concluded before the next meeting in September. The Fed routinely undertakes a wholesale review of its approach to monetary policy, and we expect a few notable changes starting later this year.

First, the Fed is likely to consider its 2% core PCE inflation target in a more symmetrical manner, permitting higher inflation when the economy is operating at full capacity to offset unavoidably low inflation during downturns like the current one.

Second, the committee's forward guidance may become more specific and outcome-focused, employing words like "until" and "unless" along with concrete economic targets that must be achieved before policy is changed in some way. Current guidance could change to include explicit unemployment and inflation targets that must be hit before the Fed hikes rates.

We'll have more to say about the new framework once it's formally announced.

NUVEEN'S OUTLOOK

The economic data for May and June was among the strongest in modern history, in part because March and April were so poor. But there is now considerable evidence that the "V-shaped" part of the recovery is over. This will validate the Fed's very cautious approach to communicating its path to "normal" monetary policy: stopping asset purchases, raising interest rates and unwinding its large balance sheet.

The Fed seems unlikely to have to entertain any of these measures for at least the next several years. Asset purchases should continue – the enormous federal deficit ensures the world will not run out of Treasuries anytime soon – and rates should stay put until 2022 even under the best of circumstances.

Barring a major breakthrough on the health care front – e.g., a vaccine – we also do not foresee a significant steepening in the U.S. Treasury curve that would take the U.S. 10-year Treasury rate much above 1% in the next six months.

INVESTMENT IMPLICATIONS

In part thanks to the Fed's aggressive open market purchases since March, U.S. Treasury yields remain anchored at all-time lows across the curve. Other high grade fixed income categories are, to some extent, tied to the Treasury market, meaning investment grade corporate and municipal bonds are also offering very low yields. There are exceptions, particularly for securities that trade with higher illiquidity premiums. But with financial conditions becoming looser by the day, high credit quality in the U.S. bond markets is becoming synonymous with very low income streams.

As we have emphasized for months, investors with income needs should look to diversify beyond a core bond portfolio into higher yielding U.S. or emerging markets credit. An income-focused equity portfolio also makes sense, as does a higher allocation to income-producing alternatives like real estate and farmland. Like the Fed's strategy for confronting the coronavirus crisis, an investor's strategy for generating income in the coming years must be multifaceted.

For more information, please visit us at nuveen.com.

Endnotes

Sources

Federal Reserve Statement, July 2020.

Bloomberg, L.P.

Glossary

A **basis point** is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.

The **Federal Open Market Committee (FOMC)** holds eight regularly scheduled meetings per year to review economic and financial conditions, determine the appropriate stance of monetary policy and assess the risks to its long-run goals of price stability and sustainable economic growth.

The **personal consumption expenditure price index (PCEPI)** is one measure of U.S. inflation, tracking the change in prices of goods and services purchased by consumers throughout the economy. Of all the measures of consumer price inflation, the PCEPI includes the broadest set of goods and services. Core PCE excludes food and energy prices.

A word on risk

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