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The Fed pushes ahead with dovish policy framework

As was widely expected in markets, the Fed
left rates unchanged yesterday at 0-0.25% while keeping its bond-buying program and credit facilities in place. The Fed said that it will wait for the economy to reach full employment and that it considers it appropriate to keep rates at current levels until inflation has risen to 2% and until longer-term inflation expectations remain anchored at 2% for some time. Concretely, this should be enough to keep a dovish bias and to keep rates at current levels for a very long time, while paving the way for a more flexible use of its balance sheet to maintain accommodative financial conditions. The refreshed dot-plot suggested that FOMC members expect rates would remain at current levels until at least the end of 2023. This follows Jerome Powell's speech last month at Jackson Hole, in which he announced a new strategic policy framework that pursues an average inflation target, meaning that the 2% inflation target will be adjusted upwards to "make up" for past shortfalls.

On the bright side, the Fed's growth
expectations now foresee a 3.7% decline in GDP this year, a smaller contraction than the 6.5% decline expected in June. The Fed is projecting that the US economy will reach pre-Covid levels by the end of 2021. Powell said that "the recovery has progressed more quickly than generally expected," bud did caution by stating that "activity remains well below pre-pandemic levels" and noted that the pace may slow as "the path ahead remains highly uncertain." Covid-19 remains the primary risk to the outlook, and the Fed expects that the road back to normal is a long one.

Fiscal policy measures have provided
critical support and more will likely be needed, but how much and when it happens is uncertain. So far, the economy has proven resilient to the expiration of benefits. However without further fiscal aid, more downside risk is to be expected.

For
investors, lower for longer just got even longer. With a new and higher inflation target, the Fed had two possibilities, either more aggressive QE or looser for longer. It opted for the second, mildly disappointing market participants. Our take away is that the global hunt for yield will likely further intensify, keeping in mind that it doesn't pay to fight the Fed. With lower

rates taking the shine off of other investments and with more tolerance on the inflation front, the case for gold as an additional buffer remains well intact.

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