US Fed maintains status quo

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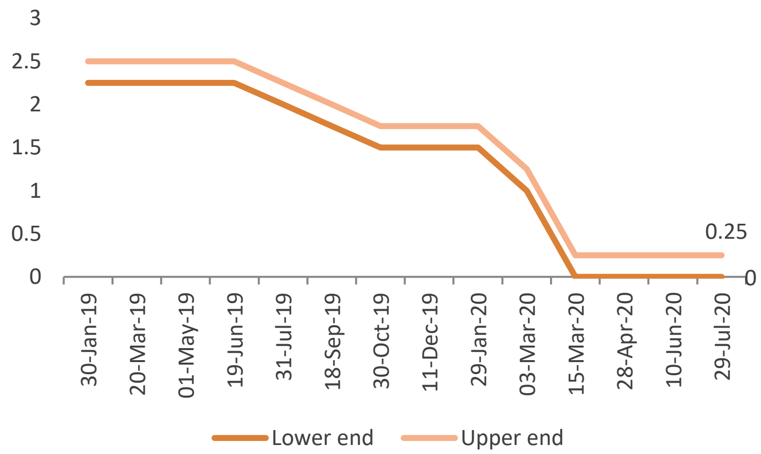
The Federal Reserve's Open Market Committee unanimously decided to maintain the federal fund rate at **0 – 0.25%** in its recently announced monetary policy in light of the impact of the pandemic on the US economy and the considerable near term and medium term risks on economy activity, employment and inflation. The Committee expects to maintain this target range until it is confident that the US economy has weathered the pandemic and is on track to achieve its maximum employment and price stability goals.

This is the **third policy meeting when the Committee has decided to maintain status qu**o after slashing the federal fund rates from 1.5-1.75% to 0-0.25% in the month of March 2020 following the outbreak of the coronavirus pandemic.

Chart 1: Movement in federal fund rate (%)



Source: Federal Reserve

Assessment of the economy:

- Following the sharp decline in economic activities during March-April 2020, economic activity and employment have picked up somewhat in recent months but it remains well below the levels at the beginning of the year.
- Weaker demand and significantly lower oil prices are holding down consumer price inflation. **CPI retail rose to 0.6% in June 2020 but is well below the 2% target rate set by the FOMC**. Inflation has averaged 0.3 % during Q2-2020. Subdued demand in sectors like travel and hospitality has held prices lower but supply constraints have led to notable pickup in food inflation.
- Overall financial conditions have improved in recent months, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

- The household spending has increased supported by moderate pick-up in business activities, federal stimulus payments and expanded unemployment benefits. However, indicators of business fixed investments are yet to see recovery.
- **The US unemployment rate at 11.1%** in June is far less than the one recorded in April (14.7%) and May (13.3%) but is far above the level before the outbreak (3.5-3.6%) and the peak recorded during the 2008-09 global financial crisis.
- Along with the recent increase in economic activity, the **challenge of surge in coronavirus cases has resurfaced** and thus the US economy has entered a phase of containing the virus and protecting the economy. The **path forward looks extraordinarily uncertain** and will depend on the success to keep the spread of the virus in check.

Outlook on the US economy: The pandemic will weigh heavily on economic activity, employment and inflation in the near term and there is a considerable risk over the medium term. There will be continuous monitoring of the implications of incoming information (especially public health information) on the overall economy.

Liquidity measures to continue:

The US Fed has been purchasing sizeable quantities of Treasury and agency mortgaged-backed securities, which are vital for credit flow in the economy. To support the flow of credit to households and businesses, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency residential and commercial mortgage-backed securities at least at the current pace to sustain smooth market functioning. In addition, large-scale overnight and term repurchase agreement operations will also continue.

Additional announcements

- The Federal Reserve plans to extend its various lending programs to business, government and individuals till December 2020.
- Extension of the temporary US dollar liquidity swaps lines and repurchase agreement facility for international monetary authorities till March 31, 2021.

Market reactions

- US equity markets rose with **Dow Jones rising by 0.6%** while **NASDAQ and S&P 500 gaining around 1.3% each** supported by the Federal Reserves' assurance on more support to the US economy.
- The **10 year benchmark US treasury yields** ended marginally lower by 20 bps at 0.58% following the decision by the Committee to hold the Fderal fund rate at 0-0.25% until the economy recovery.
- The **US dollar** has weakened against major currencies like Euro, Pound and Yen.

What will the RBI's policy response be?

The RBI response is not linked with what the Fed does. While global developments are examined, the decision taken by the MPC is based on the mandate i.e. inflation targeting. However, of late growth due to pandemic conditions has been the over-riding factor. We do think that the RBI may on balance hold back on rate cuts this time as inflation is high even though growth is retarded. With unlocking beginning and some sectors showing upward movement, the RBI may choose to hold on to a rate cut and continue to monitor availability of liquidity in the system.

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