In the first monetary policy of the new calendar year 2021, the Federal Reserve’s Open Market Committee (FOMC) unanimously decided to maintain the federal fund rate at 0 – 0.25% and is committed to using its full range of policy tools to support the US economy in this challenging times. The Committee asserted that it will be appropriate to maintain the policy rates in this target range until labour market conditions are consistent with the assessment of maximum employment and inflation averages 2% over time. It also expects to maintain an accommodative stance until these outcomes are achieved.

The FOMC believes that the pace of economic recovery in the USA has moderated in recent months with weakness concentrated in the sectors most adversely affected by the pandemic. The path of the economic recovery is contingent upon the course of the virus and the progress of the vaccinations. The ongoing public health crisis continues to weigh on economic activities, employment, inflation and poses considerable risks to economic outlook.

It is to be noted that IMF’s outlook on the US economy (GDP growth 5.1%) for 2021 is notably higher than US Fed’s projections on economic growth (4.2%)

Assessment of the US economy:

- Economic activities in the US economy continue to recover from the depressed Q2-2020 level. Real GDP growth for the US economy was estimated to contract by 2.9% in Q3-2020, significantly narrower than the (-) 9% de-growth recorded in Q2-2020.
- A resurgence of cases and deaths in the recent months is weighing on economic activity and job creation and has moderated the pace of recovery.
- The household spending on goods has moderated following earlier larger gains while the spending on services remains low, especially in sectors that require more people to gather closely.
- There has been an impressive turnaround in the housing sector supported by low mortgage interest rates while production activity has also picked up.
- The overall economic activity remains below its level before the pandemic and the path ahead is highly uncertain.
- The pace of improvement in the labor market has moderated to some extent. The unemployment rate remains unchanged for the last 2 months and at elevated levels of 6.7% in December.
- Inflation continues to remain benign owing to weaker demand and earlier fall in crude oil prices. Inflation stood at 1.4% in December 2020, lower than the inflation target of 2%. Prices have remained soft for the sectors which have been most adversely affected by the pandemic.
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.
- The US Fed is purchasing holdings of Treasury securities and agency mortgage backed securities at $120 bn per month - $80 bn per month of Treasury and $40 bn of mortgage backed securities. This is likely to continue until substantial further progress has been made towards maximum employment and price stability goals.
- In addition, large-scale overnight and term repurchase agreement operations will also continue.

Outlook on the US economy

- The outlook is extraordinarily uncertain and is contingent on the course of the virus and the vaccination program. Additionally, support from fiscal policy will also help households and businesses weather the downturn as well as limit the lasting damage to the economy.
- GDP growth projections for the US economy has been pegged at 4.2% for 2021 and gradual moderation subsequently in 2022 (3.2%) and 2023 (2.4%). These projections were made by the US Fed in the December 2020 policy. IMF, in its World Economic Outlook (Jan 2021) has projected GDP growth at 5.1% (higher the US Fed) in 2021 and 2.5% (lower than US Fed) in 2022.
- Retail inflation projection for 2021 and 2022 is projected to be just below the 2% target and 2% for 2023.
- US unemployment rate is estimated to decline gradually to 3.7% in 2023.

Market Reactions

The US equity markets (US Dow -2.1%, NASDAQ -2.6%, S&P 500 -2.6%) fell by more than 2% while US 10 year benchmark treasury yields fell by 2.6 bps following the comments from the US Fed Chairman that the pace of recovery in the US economy has moderated in recent months. The markets sentiments have also been dampened by heightened stock market valuations, rising coronavirus cases and uneven distribution of the vaccines. US dollar strengthened against major currencies owing to safe-haven demand amidst rising coronavirus cases and challenges to vaccine rollouts.