

# FED WATCH: 'NEW' POLICY FRAMEWORK, BATTERIES NOT INCLUDED

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The [Federal Reserve \(Fed\)](#) released its new policy framework, formally known as the Statement on Longer-Run Goals and [Monetary Policy](#) Strategy, late last month in connection with Chair Powell's Jackson Hole speech. After that, it is not surprising the September [FOMC](#) meeting failed to provide any fresh headlines. The key question now is how does the Fed actually implement this new approach? There really is no precedent to go by, and the 'assembly directions' have significant potential for misinterpretation by the markets.

As a reminder, at the heart of this new framework, the policymakers will now be using an average [inflation](#) target of 2% "over time." To quote the Fed's own statement, "following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time." Okay, sounds good in theory, right? I thought so...

How about in real time? I don't want to be overly critical or run the risk of putting the cart before the horse. But in my experience, policymakers don't have the greatest track record when it comes to implementing new policy initiatives. It's easy to let the various facilities run off the [balance sheet](#) if they are no longer being used, but the tricky part comes when action needs to be taken.

Communication—a.k.a. forward guidance—will be of critical importance. Does everybody remember 2013's [taper tantrum](#)? As I mentioned earlier, the chance of market misinterpretation runs high. What exactly does "appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time" mean? What is "moderately above"? Is that 2.25%, 2.5%, or even higher? For that matter, what does "for some time" mean? Three months, six months, a year?

Another important aspect to consider is that the Powell-led Fed has shown it is susceptible to market reactions. One more trip down memory lane: the final [rate hike](#) in 2018—remember how well that went? Just seven months later the Fed reversed it!

**Bottom line:** I readily admit the Fed will not be raising rates and/or reducing its [quantitative easing \(QE\)](#) purchases any time soon. However, the implications of this new policy framework cannot be underestimated. The bond market's response to 'letting things run hot' definitely has the potential to put a wrench in the policymakers' best laid plans. Want another fun tidbit? Powell's term as chair ends in early 2022. In other words, he may not even be around to actually implement this new approach!

***Unless otherwise stated, all data sourced is Bloomberg as of September 11, 2020.***

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## DEFINITIONS

**Federal Reserve** : The Federal Reserve System is the central banking system of the United States.

**Monetary policy** : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

**Federal Open Market Committee (FOMC)** : The branch of the Federal Reserve Board that determines the direction of monetary policy.

**Inflation** : Characterized by rising price levels.

**Balance sheet** : refers to the cash and cash equivalents part of the Current Assets on a firms balance sheet and cash available for purchasing new position.

**Taper tantrum** : a period in which global interest rates rose dramatically in 2013 as a response to a shift in monetary policy by the Federal Reserve.

**Rate Hike** : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

**Quantitative Easing (QE)** : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.