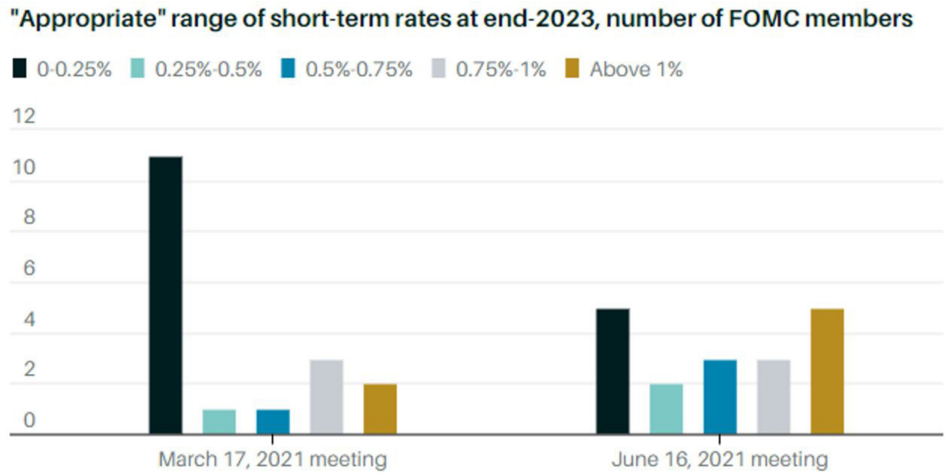
Week in Review

Friday, June 18th 2021

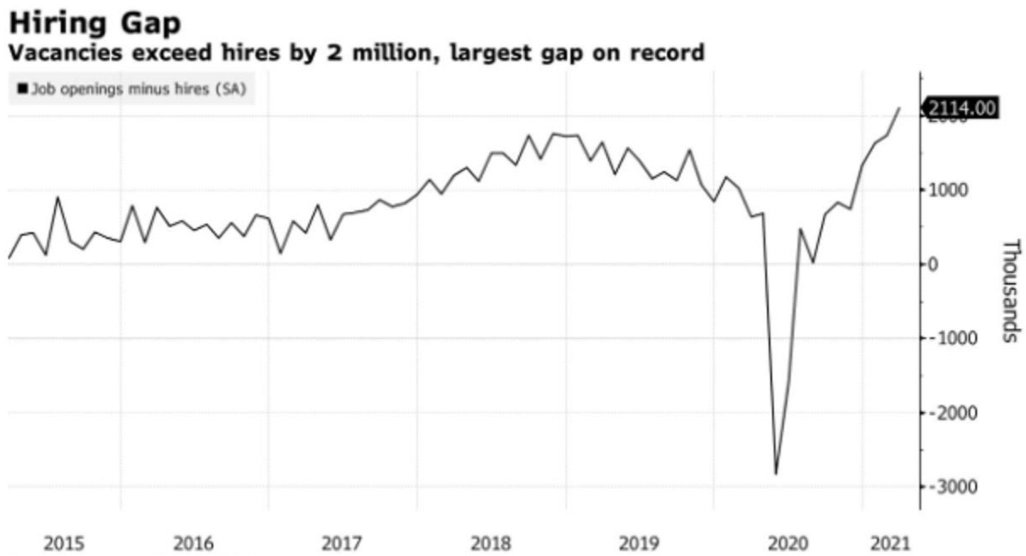
1. The "Most" Anticipated Federal Reserve Meeting Takes Place

The Federal Reserve (Fed) finally confirmed that sufficient progress has been made in the economy catalyzed by a successful vaccine rollout that a tightening of monetary policy, while not imminent, is in the future. A key data point released by the Fed was that 13 of 18 of its policymakers projected moves up by the end of 2023 for the federal funds rate, the rate of interest that commercial banks get on their excess reserves deposited at regional Federal Reserve Banks. The consensus expectation now is for the benchmark rate to move up to an average of 0.6% by the end of 2023 from near zero today. This is a change from their opinion just three months ago where 11 of them expected no change before the end of 2023. Perhaps even more telling, 7 now believe rate increases will start by the end of 2022.



Source: Federal Reserve Board

The Fed also breached the topic of its open market operations. The Fed has been purchasing at least $120 billion a month of Treasury and mortgage bonds since June 2020, adding more money to the economy which brings interest rates down and reduces longer-term borrowing costs. While the Fed stated that it expects to continue bond purchases, it also stated that it will begin to discuss reducing the pace of purchases as substantial further progress is made in the recovery, getting the economy closer to maximum employment and sustained 2% inflation. With a high number of employment positions going unfilled and the Fed's measure of inflation projected at 3.4% in the fourth quarter of 2021, up from their prior forecast of 2.4%, the conditions for at least serious discussion of tapering appear to be set.



Source: Bureau of Labor Statistics

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While a change in the Fed's perspective was not unexpected, the release did catalyze a temporary rise in the government bond yields from their recent pullback and a shuffling of stock sector performance.

An important longer-term message, however, was that the Fed does see the economy recovering and that they will be measured in changing policy.

2. Commodity Inflation

A key consideration by the Fed and investors has been inflation. This has been clearly seen in commodity prices this year as demand has increased, inventories remained low, supply constraints from operations were brought back online, and distribution bottlenecks have needed to be overcome. However, the plateauing, and in some cases fall, in commodity prices over the recent weeks suggests that these hurdles brought upon by the rapid pace of economic recovery may be abating.

Source: Factset

An abatement in commodity prices is likely to be a positive for sustaining overall economic growth as pricing increases may be less onerous, sustaining demand, and inflation may be more subdued, limiting the pressure on the Fed to raise rates more aggressively.

3. COVID-19 Vaccination Progress Continues

A key to the Fed's changing policy has been the progress made over-coming the COVID-19 pandemic. Absent from their policy statement was prior language concerning the health crisis weighing on the economy. Driving this positivity has been the success of vaccinations with the percentage of U.S. adults fully vaccinated rising to 54.8% this week. In other vaccine news, another company, Novavax, announced greater than 90% effectiveness for its vaccine adding to the stable of effective COVID-19 vaccines available. This is important both for the U.S. and world population, which is still well behind the U.S. in vaccination penetration. Of concern is the Delta variant, first identified in India, which is particularly contagious and now identified in more than 80 countries and 30 U.S. states. While great progress has been made in putting the COVID-19 pandemic behind, risks still exist.

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Thinking Ahead

Monetary policy, inflation, and the sustainability of the economic recovery remain of key interest in benchmarking the investment landscape. Pallas Capital Advisors will continue to monitor economic, political, and corporate data for implications to markets.