

Macro Flash: Federal Reserve – change to forward guidance

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The Federal Reserve signaled through its rates forecast that it will hold rates steady until 2023 as it updated its so-called dot plot. It clarified its forward guidance to be 2% inflation heading higher and maximum employment over the longer run and expects to run inflation moderately over 2% for some time. Hence, the debate regarding forward guidance is, for now, beyond 2023.

As the economy improves and we head into 2022, the debate will be about how we define “maximum employment.” According to the Fed, it is “the highest level of employment or lowest level of unemployment that the economy can sustain while maintaining a stable inflation rate,” often referred to as NAIRU (non-accelerating inflation rate of unemployment).

Given that the last business cycle had a fairly tight labor market with little sign of strong inflation, maximum employment is very unclear. There are pools of workers that are not easily available for work (e.g. age, disease), must be retrained or can't participate because childcare is horrendously expensive or not available. All of these factors give us a sense that the participation rate can increase from relatively low levels, but only up to a point. For that to happen, wages need to increase significantly and that is a very difficult prospect.

What will likely happen is a rising automation as the labor market tightens, while wages rise in areas of innovation (e.g. Google) and in sectors where further automation is difficult (e.g. construction, farming). Much as the previous cycle, we likely won't get great traction in terms of wages, and the kitchens of McDonalds will end up being fully automated. That is good for equities, but disappointing for workers in a global economy with massive slack in the labor market.

What does it mean?

Interest rates are very likely going to stay very low until 2023. This is good news for borrowers, not so much for savers. Additionally, a long period of low interest favors the emergence of new technologies and business models and is generally speaking supportive for equities. Over time as the labor market tightens, we should see an acceleration in the demand for disruptive technologies.

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