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Jerome Powell Sees Fed's Limits and Punts to Congress.

The central bank opts against extending the maturities of its bond purchases and instead leaves the heavy lifting to Washington lawmakers.

Perhaps it's because my alma mater, Northwestern, is competing in the Big Ten Championship Game this weekend against Ohio State, but I can't help but use a football analogy to explain Wednesday's prudent decision by the Federal Open Market Committee.

The Federal Reserve has clearly done an admirable job of defending the world's largest economy from a steep and prolonged fallout from the Covid-19 pandemic in 2020. Since March, the central bank has lowered short-term interest rates to near-zero, bought wide swaths of U.S. Treasuries and mortgage-backed securities and even provided a backstop for corporate debt and municipal bonds.

Yet it's clear to most central bank observers that there's not much the Fed can do beyond what it has already done to propel the U.S. economy back toward full employment and steady inflation around 2%. The much bandied-about option — extending the weighted average maturity of its bond purchases — would hardly do much to move the ball forward, given that so many homeowners, corporate treasurers and municipal governments have already taken advantage of rock-bottom borrowing costs and wide-open capital markets during the year.

In football terms, clamping down on the long end of the yield curve now to boost economic growth would be the equivalent of Northwestern going for an early conversion on fourth-and-10 from its own 25 yard line. The likelihood of success is low. It would probably put the vaunted Wildcats defense in a tougher spot. The smart play is to punt.

That's exactly what Fed Chair Jerome Powell and his colleagues did, putting the fate of the economy in the coming months in Congress's hands.

The FOMC left the fed funds rate unchanged in a range of 0% to 0.25% and didn't tweak the composition or pace of its asset purchases after its two-day meeting. It only adjusted the language around how long the central bank would keep up its monthly purchases of $80 billion of Treasuries and $40 billion of agency mortgage-backed securities, saying it would do so "until substantial further progress has been made toward the Committee's maximum employment and price stability goals." That leaves policy makers with ample wiggle room to monitor the economic recovery in the coming years and leaves no doubt that when the Fed decides to scale back accommodation, it will first cut back on its bond buying before raising interest rates. 1

As for when the first interest-rate increase might come, not much has changed since September. One official still sees the first one in 2022. Five of the 17 members saw the fed funds rate above its current range by 2023, up from just four in September. This aligns with the Fed's updated economic projections: The central bank now sees 4.2% economic growth in 2021 and 3.2% in 2022, up from 4% and 3% in September, and an unemployment rate of 5% in 2021 and 4.2% in 2022, down from 5.5% and 4.6% previously. In 2023, the jobless rate may drop to 3.7%, within a hair of the half-century low set before the pandemic, though inflation might have a hard time cracking 2% in the coming years.

Put together, it was hard to make the case that long-term Treasuries needed to be contained. The benchmark 10-year yield hasn't crossed 1% since March and fluctuated around 0.92% after the Fed's decision. The yield curve from five to 30 years is near the steepest since late 2016, but that's healthy during an economic recovery. It's hardly derailed the steady march lower in 30-year U.S. mortgage rates, now at 2.71%, the lowest in at least a half-century, according to Freddie Mac data, which Powell credited when declaring the housing market had fully recovered from the downturn.

"In the near term, the help that people need isn't just from low interest rates that stimulate demand over time and work with long and variable lags," Powell said. "It's really support."

Clearly, the Fed understood that it didn't need to depress interest rates even further. In fact, given how much financial conditions have eased throughout the year — Goldman Sachs Group Inc.'s gauge is close to a record — there's a strong argument to be made that simply by leaving monetary policy unchanged in the face of record-high stock prices and wide-open capital markets, the central bank is passively taking an even more accommodative position.

"Financial conditions are highly accommodative — we monitor a range of financial condition indexes, there are many of them, and they'll all pretty much tell you that," Powell said. "The parts of the economy that are weak are the service-sector businesses that involve close contact. Those are not being held back by financial conditions but rather by the spread of the virus."

That was Powell's way of saying that fiscal policy needs to do the heavy lifting for the remainder of the pandemic. But just to leave no doubt, he later added that "the case for fiscal policy right now is very, very strong, and I think that's widely understood." As it stands, congressional leaders are rushing to finalize a coronavirus relief package by the end of the week that's expected to be worth less than $900 billion.

The Fed may yet have to take additional measures to prop up the U.S. economy. There could come a time when long-term yields rise to a level that the central bank sees as detrimental to a full recovery. But it's not when 10-year Treasuries are at less than 1%. Powell isn't going to get caught pushing on a string.

1. Fed officials have said they won't raise the fed funds rate "until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time."

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