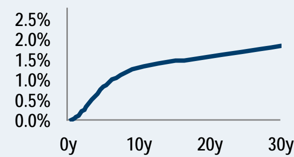
Janney

September 22, 2021

BEGGING FOR THE TAPER

- The Federal Reserve held steady its target for overnight rates to a range of 0 – 0.25%, as it has for about 18 months
- It looks like policymakers are waiting for the financial markets to beg them to taper bond buys before actually embarking
- There were indications in the statement that the FOMC will announce a $5 billion - $10 billion/month taper at the Nov. meeting
- For now, bond buying will continue at the current $120 billion/month pace ($80 billion USTs plus $40 billion MBS)

Treas.	2.15PM	1.45PM	Chg.
3mo	0.02	0.02	-(0.00)
2yr	0.22	0.22	+0.00
5yr	0.83	0.83	-(0.00)
10yr	1.30	1.31	-(0.01)
30yr	1.84	1.85	-(0.01)
3m/2s	20	20	+0
2s/10s	108	109	-(1)
2s/30s	162	163	-(1)



Federal Reserve Chair Jay Powell wrote the script for the September FOMC meeting at last month's Jackson Hole Conference, a matter we discussed in the note Pace over Timing. The quick version is that the Fed will wait for the markets to essentially beg them to begin tapering bond purchases, and, at that time, market narrative will shift to emphasizing the pace of tapering as the most important policy variable. At today's FOMC meeting—at least according to the statement—it looks like that process is beginning. Policymakers maintained overnight interest rates at the zero lower bound and directed the NY Fed to continue buying bonds at a $120bln/month pace, but also hinted that the time for reducing those buys is nigh.

Economic data since the FOMC met in July has been mixed. Employment gains were strong in July, but weaker in August. Some of the weakness stems from post-COVID seasonal adjustment problems that are swinging education jobs +/- 200K, but the headline was nonetheless disappointing. In a similarly mixed vein, consumer spending moved from weak (as Delta variant worries coursed through the economy) to strong, at least as measured by August retail sales. Inflation, meanwhile, has moderated in terms of the latest core CPI reading, but mainly because the extremely volatile used car, airfare, and hotel categories that spiked early in the summer fell back down to earth. Other less-volatile sectors showed a slight uptick in inflationary pressures. The broad sweep of both growth and inflation data, however, is that we cannot say with confidence that much has changed since the July FOMC meeting.

When it comes to the FOMC statement, a few prominent edits indicate policymakers are ready to begin reducing bond buys. First, the FOMC's comment on the trajectory of recent economic data was little changed, reflecting the same sentiment above: it is hard to get an accelerating/decelerating/stable read from last two months' data. The one small change in the statement is that inflation "is elevated," but no longer "rising," a hint that higher CPI/PCE prints are less likely. Second, and most important, the statement institutionalized Powell's Jackson Hole comments that we made "progress towards [job] goals." The difference is small, but "progress" is enough to reduce bond buys, whereas "substantial further progress" is the standard policymakers set for rate hikes. And indeed, the committee did note that "a moderation in the pace of asset purchases may soon be warranted." In other words, if everything goes reasonably smoothly, that means a November FOMC meeting taper announcement. Expect Powell in today's press conference to emphasize that the FOMC will be able to vary the pace of reductions as a further policy tool.

In addition to the statement, the September meeting includes updated economic projections ("SEP") and the dot plot representing policymakers' expectations for rate hikes or cuts. Recall the combination of lower inflation forecasts and more hikes at the June FOMC projections sent long-term interest rates sharply lower. September's dots are not a repeat of June's, but they are close. Inflation forecasts went up slightly, but the median forecast now implies three rate hikes in each of 2023 and 2024, up from 1.5 hikes in 2023 (September is the first time we have 2024 information).

Initial market response to the statement had the level of rates little changed, the curve slightly flatter, and equities substantially stronger—the highs of the day, in fact. More to come at Powell's presser.

FEDERAL RESERVE press release

The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals.

• Inflation is no longer "rising," but is elevated, a cause of slightly reduced concern

With progress on vaccinations and strong policy support, indicators of economic activity and employment have continued to strengthen. The sectors most adversely affected by the pandemic have improved in recent months, but the rise in COVID-19 cases has slowed their recovery. Inflation is elevated, largely reflecting transitory factors. Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

• Risks still skewed to downside in Fed's view, surprisingly

The path of the economy continues to depend on the course of the virus. Progress on vaccinations will likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remain.

• Bond buying continues at $120bln/mth, but reductions are coming, likely at the Nov. FOMC as long as the economy cooperates reasonably well

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation having run persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range 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. Last December, the Committee indicated that it would continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward its maximum employment and price stability goals. Since then, the economy has made progress toward these goals. If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Raphael W. Bostic; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Mary C. Daly; Charles L. Evans; Randal K. Quarles; and Christopher J. Waller.

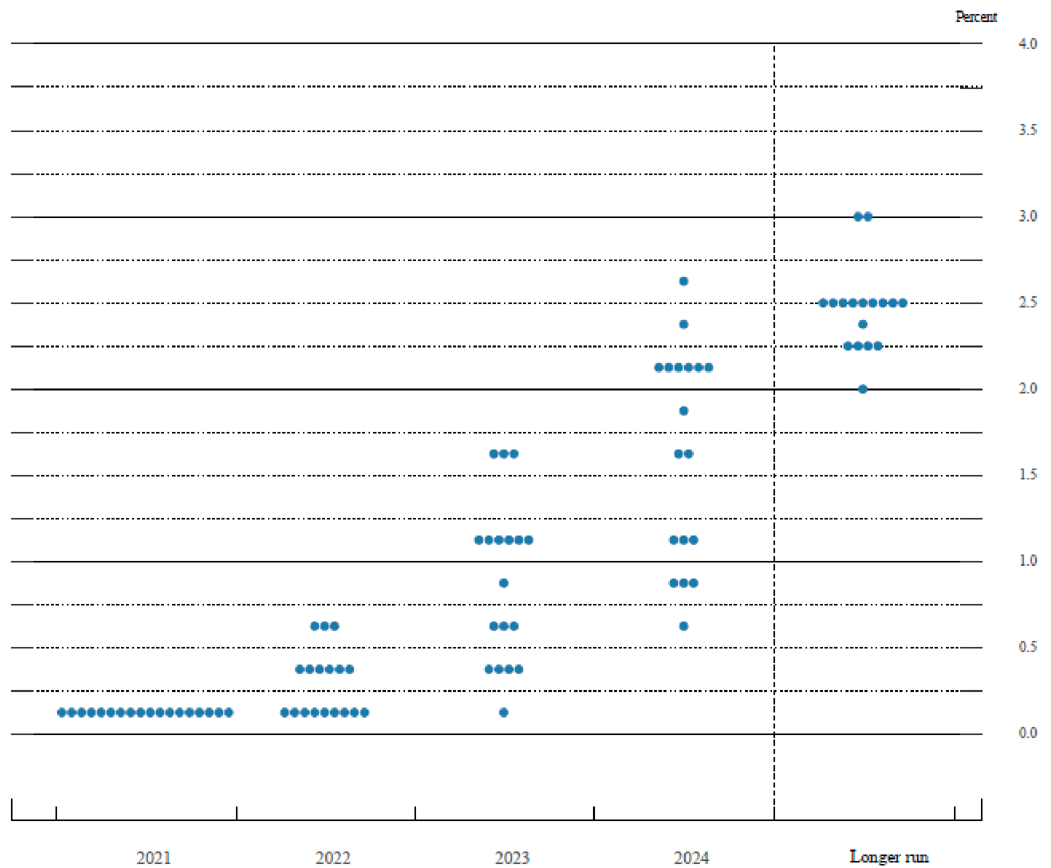
• Updated median Fed forecasts have 2022 core inflation 0.2% and 2023 core inflation 0.1% higher than June, forecasts

Percent

Variable	Median[1] 2021	Median[1] 2022	Median[1] 2023	Median[1] 2024	Median[1] Longer run	Central Tendency[2] 2021	Central Tendency[2] 2022	Central Tendency[2] 2023	Central Tendency[2] 2024	Central Tendency[2] Longer run	Range[3] 2021	Range[3] 2022	Range[3] 2023	Range[3] 2024	Range[3] Longer run
Change in real GDP	5.9	3.8	2.5	2.0	1.8	5.8–6.0	3.4–4.5	2.2–2.5	2.0–2.2	1.8–2.0	5.5–6.3	3.1–4.9	1.8–3.0	1.8–2.5	1.6–2.2
June projection	7.0	3.3	2.4		1.8	6.8–7.3	2.8–3.8	2.0–2.5		1.8–2.0	6.3–7.8	2.6–4.2	1.7–2.7		1.6–2.2
Unemployment rate	4.8	3.8	3.5	3.5	4.0	4.6–4.8	3.6–4.0	3.3–3.7	3.3–3.6	3.8–4.3	4.5–5.1	3.0–4.0	2.8–4.0	3.0–4.0	3.5–4.5
June projection	4.5	3.8	3.5		4.0	4.4–4.8	3.5–4.0	3.2–3.8		3.8–4.3	4.2–5.0	3.2–4.2	3.0–3.9		3.5–4.5
PCE inflation	4.2	2.2	2.2	2.1	2.0	4.0–4.3	2.0–2.5	2.0–2.3	2.0–2.2	2.0	3.4–4.4	1.7–3.0	1.9–2.4	2.0–2.3	2.0
June projection	3.4	2.1	2.2		2.0	3.1–3.5	1.9–2.3	2.0–2.2		2.0	3.0–3.9	1.6–2.5	1.9–2.3		2.0
Core PCE inflation[4]	3.7	2.3	2.2	2.1		3.6–3.8	2.0–2.5	2.0–2.3	2.0–2.2		3.5–4.2	1.9–2.8	2.0–2.3	2.0–2.4	
June projection	3.0	2.1	2.1			2.9–3.1	1.9–2.3	2.0–2.2			2.7–3.3	1.7–2.5	2.0–2.3		
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.3	1.0	1.8	2.5	0.1	0.1–0.4	0.4–1.1	0.9–2.1	2.3–2.5	0.1	0.1–0.6	0.1–1.6	0.6–2.6	2.0–3.0
June projection	0.1	0.1	0.6		2.5	0.1	0.1–0.4	0.1–1.1		2.3–2.5	0.1	0.1–0.6	0.1–1.6		2.0–3.0

• Dots moved up slightly, consistent with increased inflation forecast with median dot now indicating ½ hike in 2022, 3 hikes in 2023, and 3 hikes in 2024

• Not all dots are created equal, however, and it is hard to know if those increases come from FRB voters or regional presidents with less influence



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