MNI Market Analysis

All Signal, No Noise

MNI Fed Preview: July 2021

Meeting Dates: Tue-Wed, 27-28 July
Decision/Statement: Wed 28 July at 1400ET / 1900BST
Press Conference/Q&A: Wed 28 July at 1430ET / 1930BST

Minutes: Wed 18 Aug

Links (likely URLs based on previous meetings):
Statement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20210728a.htm
Implementation note (if applicable):
https://www.federalreserve.gov/newsevents/pressreleases/monetary20210728a1.htm
Press Conference: https://www.federalreserve.gov/monetarypolicy/fomcpresconf20210728.htm

MNI Review of Previous FOMC (Jun): https://roar-assets-auto.rbl.ms/documents/10504/FOMCRevJun2021.pdf

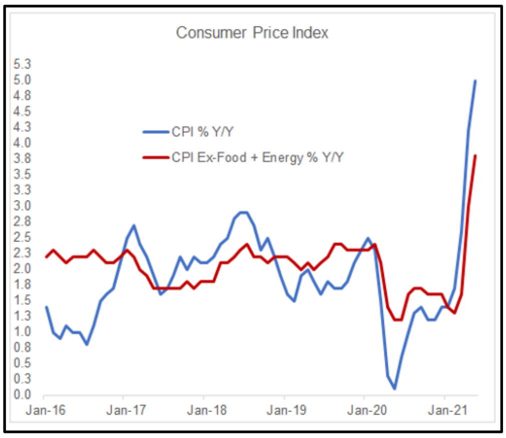
Contents

MNI POV (Point Of View): A Little Closer To Tapering

By Tim Cooper

- *The FOMC will use the July meeting to debate its strategy to taper asset purchases (including timing, pace, and composition). The December FOMC looks like the most likely meeting for a formal announcement.*
- *The risks to the July Statement lean hawkish, but the mood could swiftly change with Powell delivering a relatively dovish press conference.*
- *Moves in yields since the June FOMC suggest increasing market concerns over the growth outlook, but it's unlikely this will persuade the Fed to change course at this stage.*

The July 27-28 FOMC meeting almost certainly won't culminate in an asset purchase taper announcement, but participants will definitely get the debate going over ending asset purchases. It's a multifaceted debate: the timing, pace, and composition are all contentious areas that are likely to take at least a couple of meetings to resolve. We offer our thoughts on the likely outcomes in each of these areas. More immediately, there are a few areas of interest at the July meeting itself, though with no new economic projections/dot plot, attention will be squarely on the Statement and Powell press conference.



Inflation Means Statement Risks Lean Hawkish

The statement could see a couple of subtle but important changes as the Fed edges further toward tapering, and most of them would be hawkish-leaning. **We'll be looking for these changes in our Instant Answers (see page 4).**

- **The first regards the inflation language in the 2nd paragraph.** Powell said the following in the prepared text for his mid-July congressional testimony: *"Inflation has increased notably and will likely remain elevated in coming months before moderating."* Language to this effect could replace the June meeting statement's *"Inflation has risen, largely reflecting transitory factors."* This change of phrase is relatively neutral, and still points to the Fed's expectation that the current inflation surge will be "transitory", but would better reflect the current reality of some of the highest inflation prints in the past 4 decades.

- **On that note, a potential hawkish change could come via the phrasing of the pledge to maintain asset purchases** *"until substantial further progress has been made toward the Committee's maximum employment and price stability goals".* This could be reworded to reflect some members' views that the Committee has already met the price stability threshold to taper, but more is required on the jobs front.

- **A more hawkish risk is the changing of this phrasing in the penultimate paragraph**: *"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."* That current phrasing implies risks running in both hawkish and dovish directions. But Powell used the following phrasing in his prepared Congressional testimony (**bolding ours**): *"in assessing the appropriate stance of monetary policy, we will continue to monitor the implications of incoming information for the economic outlook and would be prepared to adjust the stance of monetary policy as appropriate* ***if we saw signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with our goal****."* That would be seen to imply that inflation risks are increasingly skewed to the upside, but also importantly reinforce that the Fed would take action if inflation expectations were to head uncomfortably higher.

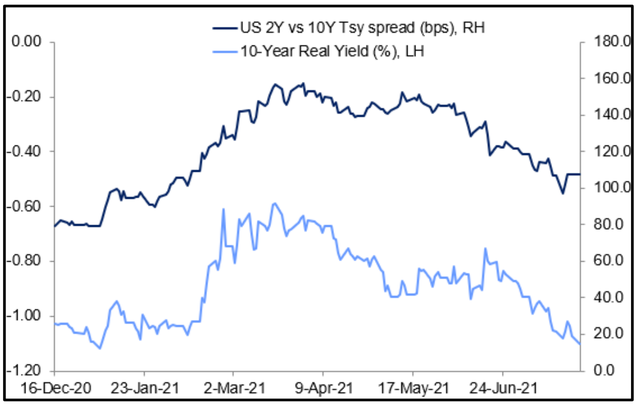
- **On the dovish side of things**, the statement could note downside risks to the economic outlook from the Delta covid variant. But this is probably captured in the existing language (the Committee takes into account *"readings on public health"*), and it's unclear that most on the FOMC will see it as a substantial enough risk to single out at this stage. Downside risks are more likely to be noted in Powell's presser.

How Will Powell Address Recent Market Moves?

Chair Powell has kept tightly to the script in recent press conferences, with the biggest market movers tending to come right at the beginning when he reveals progress (or not) in Committee taper discussions. It's very likely that his remarks at this week's press conference will echo his July congressional testimony closely. Namely, we would expect him to continue sounding a largely dovish message, in keeping with the Fed leadership's recent communications. For example:

- The Fed still regards the recent surge in inflation as "transitory"
- "Substantial further progress" on the labor market front remains "a ways off"
- Risks to the economic outlook from the pandemic remain
- The intention to taper will be communicated "well in advance"

One of the big questions since the last meeting has been the apparent disconnect between fixed income markets and the Fed's hawkish shift. This doesn't appear to have been addressed by FOMC members. In a move that began at the start of 2Q, markets have increasingly priced out the potential for a sustained Fed rate hike cycle, and the yield curve has flattened substantially. Following the hawkish mid-June FOMC meeting outcome, the rates market implied that earlier Fed liftoff meant there would not be as much room to hike. The Delta COVID variant/econ slowdown - combined with more-aggressive-than-expected Fed SEP hike dots - is one potential fundamental narrative for this.



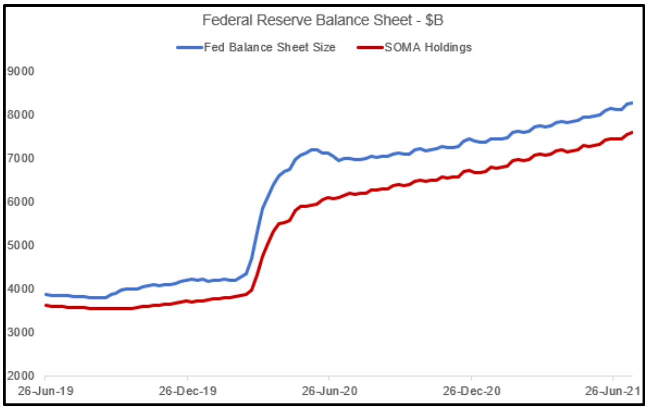
FOMC members earlier this year mostly lauded higher yields as reflective of expectations for a robust economic recovery, so it will be interesting to see how Powell addresses this topic. The doves could argue that the market is pricing in a significant slowdown in growth, implying that the Fed's taper and hiking timeline is too restrictive. But the hawks could argue that the move has been orderly, and financial conditions have not been impaired, with equities at all time highs and risk spreads remaining tight. To the contrary, they could argue that conditions are now too easy, with 10-year real yields hitting an all-time low (-1.1269% on July 26), and inflation breakeven rates remaining elevated (2.37% 10-year), suggesting that tapering is warranted. The ambiguity of the market situation means that it's unlikely Powell will express too much concern.

December Most Likely Timing For Taper Announcement

Here is the MNI Markets view of the current state of play on Fed tapering, broken down into the main areas of debate over the next couple of FOMC meetings:

On timing: Multiple regional Fed presidents are advocating a reduction in asset purchases soon, and most on the FOMC appear open to a taper by end-2021. But most also want to see more "substantial further progress" on the labor market front, and Chair Powell says that development is "still a ways off". Markets continue to expect a taper to be announced in November or December, beginning early in 2021.

- **MNI View:** Every subsequent meeting to July is theoretically "live" for a formal taper announcement, but barring unexpectedly strong employment data by that point and/or a further surge in inflation, December looks the most likely announcement timing for a taper beginning in January 2022. Risks are probably skewed to the later side.
- A September announcement looks unlikely at this stage - this would be too abrupt given the Fed's reassurance that plenty of notice would be given, and the Fed will be eager to avoid anything resembling a taper tantrum. And as many Fed members have noted, the labor market picture is likely to remain very distorted by supply-side factors (e.g. childcare/school issues, unemployment benefits) until the fall, making the mid-September FOMC too early to judge progress. Furthermore, Powell said in mid-July that the Fed would look for inflation to move down "in six months or so", implying that they wouldn't be too concerned about a failure in the "transitory" narrative until end-year. November is a possibility should data surprise significantly to the hawkish side, but that meeting has the disadvantage of having no associated projection materials/dot plot.



On pace: The prevailing consensus is that the current $120B/monthly pace of purchases ($80B Tsy, $40B MBS) would be reduced by an average $10B a month over the course of a year (or put another way, divided up in $15B chunks over 8 FOMC meetings), but this has been one of the aspects of the taper that has been least openly discussed by FOMC participants. Ex-Fed officials told MNI that the uncertainty in emerging from the pandemic means the Fed is likely to be open to adjusting the pace if their fundamental view of the outlook changes, with a 12-month process most likely (see our Policy interview: *"Fed Looking At 12-Month, Flexible Taper - Ex-Officials"*).

- **MNI View:** There's little reason to expect anything other than a straightforward $15B per meeting reduction culminating in the end of net asset purchases by end-2022. But a "flexible", meeting-by-meeting approach may prove attractive given the uncertainty surrounding the recovery, in both directions.

On composition: Some regional presidents and Gov Waller have suggested that they'd be open to tapering MBS purchases earlier or more quickly than Treasuries, in part because house price gains have been very strong. But Powell and NY Fed Pres Williams have been lukewarm about the idea, noting that MBS buys impact broader financial conditions in a manner similar to Tsy purchases. Other members who have expressed opinions on this topic have concurred, and/or see a shift on MBS as confusing the Fed's messaging and not worth the risk.

- **MNI View:** With core leadership not on board with the idea of prioritizing MBS in the taper, and the communications issues it would entail, a simple and proportional ($10B Tsy / $ 5B MBS) taper pace is the most likely outcome.

MNI Instant Answers:

The questions that we have selected for this meeting are:

- Changes to Fed Funds / Interest Rate Paid on Excess Reserves (IOER) / ON RRP?
- Does the Fed announce changes to asset purchases with regard to size, duration, and/or Tsy vs MBS?
- Does the FOMC change the sentence "Inflation has risen, largely reflecting transitory factors" in the 2nd paragraph? If so, does it indicate inflation is less transitory than June?
- Does the FOMC say inflation will likely “remain elevated in coming months before moderating”?
- Does the FOMC change the phrase "if risks emerge that could impede the attainment of the Committee's goals" in the second to last paragraph? If so, does it add an explicit reference to inflation or inflation expectations rising above goal?
- Does the FOMC change the phrase "until substantial further progress has been made toward the Committee’s maximum employment and price stability goals"?
- Does the Fed announce the creation of a standing repo facility?
- Any dissents to the decision?

(Formerly Human Readable Algo) The markets team have selected a subsection of questions we think could be most market moving and will publish the answer to all of these questions within a few seconds of the Fed statement being released. These questions are subject to change; clients will be informed of any changes via our Edge and Bullets services. **A comprehensive list of questions is available on the MNI Monitor (available via the website here:** https://www.marketnews.com/realdisplay?product=AFM

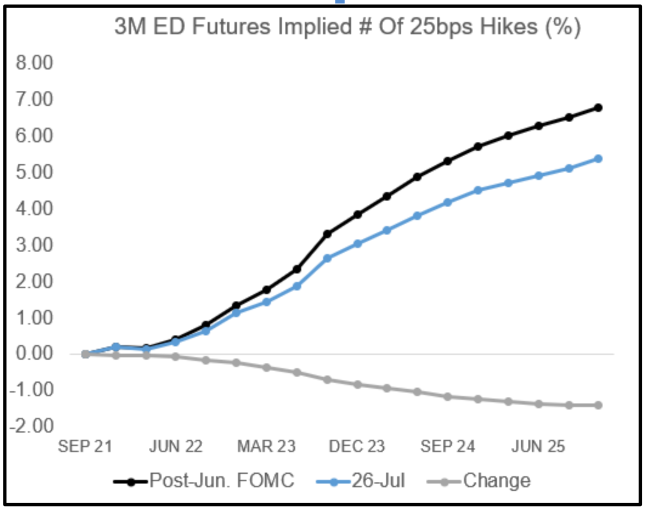
Analyst Views – Fed Outlook

- **No analysts expect Fed policy action at the July FOMC,** but opinions vary slightly on the degree to which meeting communications will be hawkish.
- **Most see hawkish risks emanating from the July meeting, particularly from the statement.**
- Some examples: **Citi** (hawkish risk that statement reflects expectation of a near-term taper), **Barclays** (statement "incrementally more hawkish"), **Credit Agricole** (risk is of 'hawkish surprise' similar to June's FOMC) **JPM** (if "material and persistent" language on inflation appears, it would be "new, asymmetric risk bias"), **Morgan Stanley** (""skewed toward an upbeat and hawkish message").
- Analysts' focus is firmly on the tapering timeline, with most not mentioning their rate liftoff outlook.
- **On tapering, consensus is firmly for a December announcement with initiation in January**, though opinions vary slightly on the pace / composition of the taper (some see MBS being tapered more quickly than Tsys but consensus is for $10B Tsy / $5B MBS taper pace).
- ***For a summary of analysts` individual notes, please see pages 11-17.***

Analyst	Timing Of Beginning Of Taper	Details
Citi	Announced in Sep, initiated in Dec	$10B Tsy/$5B MBS, done in 8 months
Credit Suisse	Later this year	MBS taper in 2021, Tsy starting in 2022
Deutsche	Announced In Nov, initiated in Dec	Starting w MBS and Tsy in equal amounts ($10B)
BNPParibas	Announced September, initiated in Jan	Multiple options; not MBS before Tsys
SocGen	Announced in Nov/Dec, initiated early 2022	
Wrightson ICAP	Announced in Nov / Dec	"Suspect" MBS faster wind-down than Tsy
ING	Announced in Dec	"Swift reduction" ending in 2Q 2022
JPMorgan	Announced in Dec	
HSBC	Announced in Dec	
Rabobank	Announced in 4Q, initiated in Jan	
Goldman Sachs	Announced in Dec	$10B Tsy/$5B MBS
Nomura	Announced In Dec, initiated in Jan	MBS $8B / Tsy $10B, ending MBS Jun '22, Tsy Nov '22
Unicredit	Announced in Dec, initiated in Jan	$10B Tsy/$5B MBS
Wells Fargo	Announced in Dec, initiated in Jan	$10B Tsy/$5B MBS
TD	Announced in Dec	$10B Tsy/$5B MBS
Morgan Stanley	Announced in Mar 2022, initiated Apr 2022	$10B Tsy/$5B MBS, done by 1Q 2023

Correct to the best of MNI`s knowledge as of Jul 26

Market-Implied Rate Outlook



Source: Bloomberg, MNI Market News. Updated July 26

- The Fed funds rate hike path has flattened since the June FOMC, with markets pricing out hikes further down the line, with between 1 and 2 25bp hikes removed by end-2025 (under 7 hikes now seen by then to 1.875%, vs an even chance of 8 or 9).

mni Central Bank Watch - FED

MNI FED Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	5.4	2.6	↑	1.4	↑					2.66
PCE Deflator	% y/y	3.9	1.6	↑	1.1	↑					1.64
UoM 1-Yr Inflation Exp	% y/y	4.8	3.4	↑	3.0	↑					1.44
Inflation Swap 5y/5y	%	2.32	2.43	↓	2.31	↑					-0.03
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
ISM	Index	60.6	64.7	↓	60.5	↑					1.10
Industrial Production	% m/m	0.44	2.66	↓	1.16	↓					-0.01
Factory Orders	% m/m	1.7	0.4	↑	1.6	↑					0.59
Housing Starts	K	1643	1725	↓	1661	↓					0.60
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Corporate Spreads BBB/Baa	bps	1.04	1.10	↓	1.09	↓					-0.99
Chicago Fed Financial Con	Index	-0.72	-0.67	↓	-0.63	↓					-1.12
Consumer Credit Net Chg	$bn	35.3	20.3	↑	10.7	↑					1.73
New Home Sales	K	769	823	↓	865	↓					-1.43
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	0.6	11.3	↓	-1.2	↑					-0.06
Consumer Confidence	Index	127.3	114.9	↑	87.1	↑					1.35
Nonfarm Payrolls Net Chg	K	850	785	↑	-306	↑					1.21
Average Hourly Earnings	% y/y	3.6	4.3	↓	5.5	↓					-0.12
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Equity Market	Index	4385	3973	↑	3756	↑					1.97
US 10-Year Yield	%	1.28	1.74	↓	0.91	↑					0.40
US Yield Curve (2s-10s)	bps	109.1	158.0	↓	79.2	↑					0.12
USD TWI	Index	90.82	92.70	↓	91.63	↓					-0.80

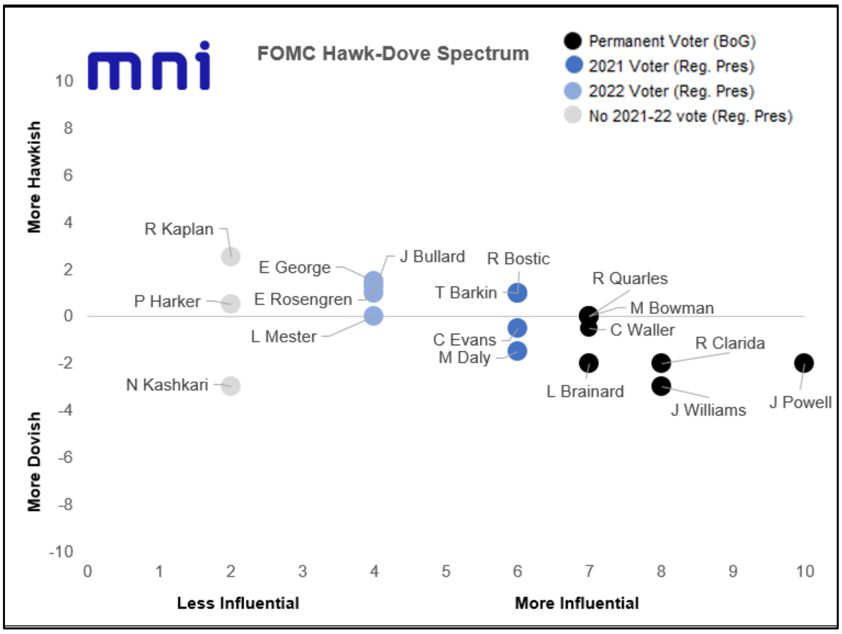
- Inflation readings have surprised to the upside in recent months, with three of the highest month/month prints in the past 40 years. Notably, while payrolls picked up in June, broader economic activity has shown signs of weakening from peak levels: indicators including the ISM, industrial production, and retail sales have failed to impress. (*Updated Jul 23, 2021*)

Key Inter-Meeting FedSpeak – Jul 2021

Here are the prevailing FedSpeak themes since the June FOMC:

The key communications of the inter-meeting period came from Chair Powell's mid-July congressional testimony, when he laid out the stakes for the July meeting (and beyond): *"While reaching the standard of 'substantial further progress' is still a ways off, participants expect that progress will continue. We will continue these discussions in coming meetings. As we have said, we will provide advance notice before announcing any decision to make changes to our purchases."* Powell elaborated that the July discussion would include the timing and composition of the taper.

- By our count, there are four FOMC members who are on the record since the June meeting as seeing 2022 hikes (there were 7 total in the June SEP dot plot): Kaplan, Rosengren, Bullard, and Bostic.
- **8 of 18 said they see potential for the beginning of asset purchase tapering** by end-2021: Kaplan, Rosengren, Bullard, Bostic, Harker, Waller, Daly, and Evans.
- **Others lean toward later tightening:** Harker and Waller said they see 2023 rate liftoff, with Evans in 2024 and Kashkari 2024 or later. Barkin and Williams appear to be leaning to a later taper (2022).
- **On prioritizing MBS tapering vs Treasuries**: Kaplan, Rosengren, Bullard, and Waller appear to be proponents. However, Powell and Williams are not, while Harker and Barkin appear to be opposed to the idea due to a desire to keep the taper strategy simple and easy to communicate.
- **Several participants reiterated that they saw inflation as "transitory" and employment far from having achieved substantial further progress**, though there were some notable exceptions: Kaplan in particular on the potential for inflation in broadening categories going into next year, and Bullard saying that the labor market appeared to be "very strong".
- **While participants were agreed on the labor market** improving in coming months, most pointed to the need for further data to determine whether "substantial further progress" was being made given distortionary labor supply constraints, noting that this would likely become clearer beginning in September.



*Our matrix uses the following methodology based on the MNI Markets Team`s subjective analysis. **Hawkish/Dovish scores** indicate MNI`s subjective assessment of each member`s stance on monetary policy. -10 implies member believes aggressive easing warranted; +10 is most hawkish, implies member believes aggressive tightening warranted. Scores around -2 to +2 considered relatively neutral. On **Influence**, the x-axis runs from 0 ('least influential') to 10 ('most influential'). Voters in the current year receive a minimum score of 6; the Chair receives a 10 and Board of Governors members receive at least 7. Those who are not voters in the current year are limited to a score of 4; among them, those due to vote next year receive higher influence scores (rising towards end of current year), and vice-versa.*

Member	Role	Voter '21	Voter '22	Monetary Policy Commentary Since June FOMC
J Powell	BOG, Chair	**X**	**X**	**On monetary policy:** "Substantial further progress is still a ways off…as we assess the progress of the economy, we will begin to reduce our asset purchases. We've set a separate test for raising interest rates, which is a higher test." **– Jul 15** **On tapering:** "We will provide lots of notice as we go forward, and we have another meeting in a couple of weeks from today, and we'll have another round of discussions on this very topic…the timing and the composition of the taper are the two main things [to be discussed]." **– Jul 14** **On raising rates:** "It would be a mistake to act prematurely … at a time when virtually all forecasters believe that inflation pressures will come down on their own accord." **– Jul 14** **On MBS purchases:** "The difference between Treasury purchases and MBS purchases for house prices is not a large one – probably MBS purchases are somewhat more supportive of housing. That's not their intent, but that may be the effect." **-Jul 15** **On inflation:** ""A pretty substantial part, or perhaps all of the overshoot in inflation comes from categories that are directly affected by the re-opening of the economy such as used cars and trucks…Those are things that we would look to stop going up and ultimately to start to decline." **-Jun 22** "Inflation has increased notably and will likely remain elevated in coming months before moderating." **– Jul 13 testimony** **On employment:** "Job gains should be strong in coming months as public health conditions continue to improve and as some of the other pandemic-related factors currently weighing them down diminish." **– Jul 13 testimony**
J Williams	NY Fed, V Chair	**X**	**X**	**On tapering:** "We set a very clear marker, not a quantitative marker, that we want substantial further [labor market] progress relative to where we were...clearly right now we have not achieved that." **-Jul 12** **On raising rates:** "Once the recovery is more complete and the economy is in a very good place, then we can take back the low interest rates and get them back to more normal levels… it's not the time now because the economy is still far from maximum employment." **– Jun 24** -[The liftoff discussion] "is still quite a ways off." **– Jun 22** **On MBS purchases:** "It's the overall purchases of both [Tsys and MBS] that are really providing stimulus…the main purpose is providing stronger financial conditions." **– Jul 12** **On inflation:** "I expect both core and overall inflation to come back down next year to around 2%." **– Jun 22** **On employment:** "I see the unemployment rate coming down to about 4.5% by the end of the year…we have made progress for sure since December, … I still don't think it's close to "substantial further progress." **-Jun 22**
R Clarida	BOG	**X**	**X**	**No commentary on current monetary policy since June FOMC**
L Brainard	BOG	**X**	**X**	**No commentary on current monetary policy since June FOMC**
R Quarles	BOG	**X**	**X**	**On inflation:** "We think that the supply-chain imbalances and the released pent-up demand that will eventually be spent to a more normal level that are driving the currently high temporary inflation numbers are transitory… Over the period of a year and a half or so, all of that will work its way out…we have set monetary policy on that expectation, but we are also very mindful that we could be wrong." **– Jun 28** **On employment:** "I don't think we can say we need to see labor participation come back up to the levels that we saw before Covid, because we are still going through the demographic wave of retirements of the baby boomers that have been sort of secularly been pushing down labor-force participation…I don't think that we can wait for all these measures to return to their pre-Covid maximums." **– Jun 28**
M Bowman	BOG	**X**	**X**	**On inflation:** "The impressive upswing in economic activity has played an important role as it has led to a number of supply chain bottlenecks and put upward pressure on prices for many goods. These upward price pressures may ease as the bottlenecks are worked out, but it could take some time, and I will continue to monitor the situation closely and will adjust my outlook as needed." **– Jun 23**
C Waller	BOG	**X**	**X**	**On tapering:** "We are now in a different phase of economic policy so it is appropriate to start thinking about pulling back on some of the stimulus…I think everybody anticipates that tapering could move up earlier than when they originally thought…whether that's this year, we'll see, but it certainly could." **– Jun 29** **On raising rates:** The unemployment rate would have to drop fairly substantially or inflation would have to really continue at a very high rate before we would take seriously a rate hike in 2022, but I'm not ruling it out…"I would like to see tapering over before we consider raising rates; therefore if you think you may have to raise rates in late 2022 or early 2023, you pretty much want to get tapering done by the end of next year if possible." **-Jun 29** **On MBS purchases:** "I am much more sympathetic to tapering MBS first…We should think carefully about doing MBS purchases, and if we were to taper those first, that wouldn't necessarily be a big issue…the housing markets are on fire, they don't need any other unnecessary support." **– Jun 29**
C Evans	Chic. Fed	**X**		**On tapering:** ""If unemployment is at 4.5% by the end of the year and things are progressing the way that I'm expecting, I would guess that some adjustment would be in order -- somewhere in that time frame [by end-2021], probably…I think [determining the achievement of "substantial further progress"] is going to take more than a couple months, I think it will take into the fall…we're going to talk about it for a couple of meetings at least." **– Jul 15** **On raising rates:** "My outlook is consistent with raising rates in early 2024 … if it was a bit earlier, that would be ok too." **-Jul 15** **On employment: "**Given more recent months of lower employment growth than I was expecting, I would say that there are still things to assess in terms of substantial further progress." **-Jul 15**

Member	Role	Voter '21	Voter '22	Monetary Policy Commentary Since June FOMC
				On inflation: ""The upside potential for inflation isn't quite as strong and sustainable as I would like… The risk is that inflation expectations are influenced by [some items that are seeing transitory price increases], and so that lifts the '22, '23 inflation rate more than I'm thinking… I don't think you can get 2.5% to 3% year after year on the basis of these relative price increases." **– Jul 15** **On MBS purchases:** "All of these asset purchases are serving a purpose for providing accommodation. It's not narrowly directed -- although it is MBS, and it seems like it is narrowly focused toward housing. It has much larger effects throughout markets and the way markets are functioning, and how there's fungibility with different types of liquidity and assets." **– Jul 15**
T Barkin	Rich. Fed	**X**		**On tapering:** "If the labor market can clear relatively quickly, then maybe it can happen sooner, but if it takes longer for the labor market to reopen, it goes a little later." **-Jul 12.** "I also have some preference for the least-drama way of moving back to normal." **– Jun 29 MNI Event** **On raising rates:** "I do want to be ready to raise rates when the conditions on raising rates based on our outcome-based guidance are met [whether or not asset purchases have finished]…obviously if you've got the ability to design a perfect world, you wouldn't raise rates and taper at the same time… [but] I don't see any particular reason to rush through it if we don't think we're going to get there." **– Jun 29 MNI Event** **On MBS purchases:** "I recognize and appreciate the arguments of folks who say the housing market is pretty hot right now [but] making the case you want to try to differentiate the kind of liquidity [the Fed is providing markets] "feels complicated." **– Jun 29 MNI Event**
R Bostic	Atl. Fed	**X**		**On tapering:** "In my view we are close to meeting that standard [of substantial further progress]…if the next few months print at levels comparable to what we have seen recently, I feel we will have reached that standard. Given that is a distinct possibility I think it is fully appropriate to be planning to start the tapering process." **– Jun 23.** "Once we start tapering, we're going to go gradual, in an orderly way." **– Jul 7** **On raising rates:** "Given the upside surprises in recent data points, I have pulled forward my projection for our first move to late 2022..I have two moves in 2023." **– Jun 23** **On inflation:** ""Conditions are in place for us to get to a consistent level of inflation that is slightly above our target." **– Jun 23** **On employment:** "It is going to take some time to get back [to pre-crisis employment]… We will start to get clearer signals on this starting in September when kids go back to school." **- Jun 30**
M Daly	S.F. Fed	**X**		**On tapering:** ""It's appropriate to start talking about tapering our asset purchases, taking some of the accommodation we provided to the economy down…we'll probably be in a good position to taper at the end of this year or early next…we'll still be in a very accommodative position with a low funds rate, but we don't need all the tools as we see the economy get its own footing." **– Jul 13** **On raising rates:** "I think it's really premature to talk about rate increases…right now we want to do the following: we need to get through the fall - the delta variant being so contagious and spreading throughout the globe and actually spreading in the U.S. - that's a risk. We just need to open the economy fully." **– Jul 13** **On inflation:** ""I really do see this as temporary, the used cars really being a good example." **– Jul 13**
P Harker	Phil Fed			**On tapering:** "I am in the camp of starting the tapering process….I'd like to see it happen sooner rather than later…I'd ideally like to complete that process before we would consider moving the fed funds rate." **-Jul 1** **On raising rates:** "My forecast before was not touching the fed funds rate until 2023. I'm still there right now, although things could change." **– Jul 1** **On MBS purchases:** "I think there are pros and cons of the arguments that are made to treat MBS differently than Treasurys. And I think that is a valid debate. I tend to be on the side of simplicity. Because we start a tapering process, keep it simple, just moving both at the same time…Let's just keep it simple so that the markets clearly understand, and we can clearly communicate what we're trying to achieve." **-Jul 1** **On inflation:** "I do think there is a risk that it's not just transitory. Right now our forecast is that it is transitory factors that are causing this inflation surge. But we also have to be humble and recognize it might not be, and therefore keep really being flexible with respect to our policy stance so that if it isn't as transitory as we think it is we're willing to act." **– Jul 1**
R Kaplan	Dall. Fed			**On tapering:** ""As we approach substantial further progress, I'm probably one who would be more on his front foot, and try to adjust these purchases sooner rather than later…These purchases are well suited to stimulating demand, but we really don't have a demand issue. We have very strong demand. We've got supply issues." **– Jul 13 MNI Interview** **On raising rates:** ""People have been assuming if you discuss tapering sooner or you start tapering sooner, it has implications that maybe that means you're going to raise the fed funds rate sooner…I actually don't think that's accurate…if we can adjust our purchases sooner rather than later and avoid doing these purchases for longer than necessary, I think it actually will give us more latitude, if it's appropriate to be patient and to make decisions about the Fed funds rate down the road…the timing of tapering is not influencing my thoughts on what I submitted on my SEP [he forecast rate liftoff in 2022]." **-Jul 13 MNI Interview** **On inflation:** "Our own view at the Dallas Fed is that PCE will end the year at approximately 3.9%, and that there's a second phase going on right now of a broadening or bleeding out of these initial extreme moves to a broader range of items." **– Jul 13 MNI Interview** **On employment:** [While] ""the job market will continue to improve and recover [we] may not see the very strong headline job growth numbers that we might have expected of a million plus per month…I'm still hopeful that on the unemployment rate that we can get back to ultimately pre pandemic levels…we are more skeptical about EPOP, and the degree of improvement necessarily you're going to get there." **– Jul 13 MNI Interview**

Member	Role	Voter '21	Voter '22	Monetary Policy Commentary Since June FOMC
				On MBS purchases: "At this stage, we're questioning whether the housing market really needs this Fed support of $40B a month….I think it would be healthier to start adjusting our purchases of Treasuries and mortgage-backed securities sooner rather than later." **– Jun 21**
N Kashkari	Minn. Fed			**On tapering:** "Once the economy is ready for us to normalize monetary policy, we will begin a gradual process of eventually tapering our balance sheet and letting it roll off as those bonds expire, just as we did after the last, after the financial crisis." **-Jul 12** "As long as inflation expectations remain anchored…let's be patient and let's really achieve maximum employment." **– Jun 18** **On raising rates:** "I still have no hikes in the SEP forecast horizon because I think it's going to take time for us really to really achieve maximum employment, and I do believe that these higher inflation readings are going to be transitory." **– Jun 18** **On inflation:** "I'm in the camp that it's transitory…it really is the labor market that I think is the most important factor in how much inflation we have on a sustained basis going forward." **-Jul 12** **On employment:** "We are still in a deep hole…all three factors [COVID, childcare, unemployment benefits] are holding back labor supply, but by September, all three of those factors should really be better, and we should see a lot more labor supply in the fall." **– Jun 25**
L Mester	Clev. Fed		**X**	**On tapering:** "We've met the conditions in terms of the inflation part of the mandate; I'd like to see further progress on the employment part of our mandate." **– Jun 22** **On raising rates:** "I am not going to reveal my dot…the discussion really should be around the asset program…then we will see how the economy evolves. Then we will be thinking about the path of interest rates after that." **– Jun 22** **On employment:** "We have heard from many contacts across the district that it is difficult to find labor. I want things to go a little bit farther in terms of some of the statistics.. I think we are going to get more clarity as we get through the summer and get to September." **– Jun 22**
E George	K.C. Fed		**X**	**No commentary on current monetary policy since June FOMC**
E Rosengren	Bos. Fed		**X**	**On tapering:** ""It's certainly time to start thinking about how quickly is it appropriate to remove accommodation."" **-Jun 25** **On raising rates:** "The criteria is that we have a sustainable inflation rate, that's 2% or above, and that we're at full employment…I do expect that it's quite possible that we will see that by the end of next year, but it does depend on whether the economy progresses as strongly as I'm expecting." **– Jun 25** **On inflation:** "There is a lot of hype around inflation right now…more than likely, this isn't likely to be a continuing problem for next year or the year after." **– Jun 25** **On employment:** "I am expecting that the unemployment rate is going to decline quite significantly over the course of this year… and arguably at full employment as we get into next year…if you look at the labor force participation rate or the employment-to-population ratio, we're still well below where we were in February of 2020. So there's still a lot of labor market slack now." **-Jun 25** **On MBS purchases:** "One of the areas that we should consider is that the tapering maybe should be in the same amounts for both Treasury securities and MBS…that would mean we'd stop the MBS program well before we stopped the Treasury program." **– Jun 25**
J Bullard	St. Louis Fed		**X**	**On tapering:** "With the economy growing at 7% and the pandemic coming under better and better control, I think the time is right to pull back emergency measures...We do want to do it gently and carefully, but I think we're in a very good position to start a taper. I don't need to get going tomorrow, but I think we're in very good shape for this." **– Jul 13** **On raising rates:** "My first increase in the [SEP projections] policy rate was late 2022 – fourth quarter 2022, so even that is still almost 18 months from now… the median of the committee is in 2023 right nowm and that seems to be a good policy path for now." **– Jul 12** "You probably don't want to be in a situation where you would have to pull in rate hikes while you are still tapering, but the committee I am sure at this point would want to keep all options open…I'm not anticipating anything like that happening." **– Jun 21** **On inflation:** "A new risk is that inflation may surprise still further to the upside as the reopening process continues, beyond the level necessary to simply make up for past misses to the low side…inflation is likely to be meaningfully above 2% over the forecast horizon." **– Jun 24** **On employment:** "On the labor market, I think we have made substantial progress." **– Jul 15**. "[The ratio of unemployed to job openings] is approaching an all-time low, suggesting a very strong labor market." **– Jun 24** **On MBS purchases:** "I am a little bit concerned that we're feeding into an incipient housing bubble… I don't think we need to be feeding that here given the situation." **– Jul 12**

Analysts' Key Comments

Note summaries in alphabetical order of institution. All analysts expect no change in the Funds rate at the July FOMC.

ANZ: Tapering Discussions To Intensify

- ANZ sees an intensification in tapering discussions at the July FOMC, with focus on timing, speed and composition – though Powell's recent comments suggests an announcement is some months off.
- **Statement:** Economic / inflation assessment, and fwd guidance, likely to remain intact.
- **Press conference:** "Powell to maintain a rigorous defence of the transitory view on recent high inflation prints, but at the same time leave the door open to a reassessment of that view if intense inflation pressures prove more persistent."
- **Future action:** Tapering to commence in Jan 2022 (no longer expect faster reduction in MBS following comments from core FOMC voters).

Barclays: Heavily Focused On Strategy

- Barclays sees the July FOMC as "heavily focused on strategy, including how to taper when the time comes and finalizing the design of the standing repo facility." That said, Barclays "strongly doubts" participants have seen enough progress at this point to signal a taper is forthcoming.
- **Statement:** To become incrementally more hawkish in the assessment of the balance of risks.
- Changing "prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the committee's goals" to: the FOMC would act if it "saw signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with our goal."
- **Future action:** Barclays sees a simultaneous / proportionate taper of MBS and Tsys, though a close call.
- Fed could agree on establishing a standing repo facility at the Jul or Sep meeting.

BMO: Infections, Inflation and Interest Rates

- BMO writes that "with the FOMC now formally talking about tapering, we're on watch for any hints or clues on where things stand."
- The Fed may conclude that the risks have risen due to the Delta Covid variant, but BMO reckons the risks are still restrained.
- Recent market moves "reflect the market's reined in and riskier economic growth expectations both at home and abroad, with the latter more pronounced and thus prodding capital inflows."

BNP Paribas: Market's Take Of Fed Hawkishness Is Overblown

- BNP sees the market's perception of the FOMC having taken a hawkish shift at the June meeting has been "overblown", as shown by Powell's dovish congressional testimony.
- Recent bond strength may reflect concerns to the economy from Delta covid / China growth, combined with a premature tightening from the Fed.
- But BNP sees the Fed having an asymmetrically dovish policy bias: "given the Fed's new commitment to be outcome based rather than outlook-based, any uncertainty, or noise in the data that clouds the outcome would err the committee on the side of caution."
- **Future action:** Formal taper announcement in September (and hints at Jackson Hole), with taper initiated in January. Communication is likely to include an analysis of the "when" (state-contingent rather than data-dependent) as well as the "how" (a list of options, from a rigid formulation of $20B/monthly purchase decline, to a more flexible framework linked to economic progress).
- Fed won't start MBS tapering earlier than Treasuries.

BofA: Powell To Aim For A Balanced Message

- **Statement:** Could be tweaked to signal that more details will be forthcoming in a future meeting.
- **Press conference:** Powell to aim for a balanced message, flagging realized progress while remaining cautious about the outlook, including downside risks from Delta variant.
- Powell may also attempt to distinguish between the decision to taper vs rate hikes, emphasizing higher trend inflation for the latter.

CIBC: No Major Changes

- CIBC doesn't see the Fed making any "major changes" to forward guidance at the July meeting, despite the economy being "far along the path to recovery".
- The FOMC "are waiting to see more healing in the labour market before changing tact."

Citi: Discussing And Deciding Details Of Taper

- Citi expects the FOMC to communicate "significant details" on tapering, including warning that tapering may be announced at an upcoming meeting – though say this "may not be much of a hawkish surprise for markets" given existing expectations for a late 2021 or early 2022 taper.
- The FOMC looks to be more focused on potential upside inflation risks given developments since the last meeting, and with 7 / 18 indicating a 2022 hike, a majority is likely to at least want to have the option to raise rates next year – meaning that the taper should be done by end-2022.
- Citi doubts the downside risks from the Delta Covid variant will have much impact on Fed decision making.
- Additionally, lower yields since the last meeting will increase the urgency to taper for FOMC members who are concerned about financial stability.
- **Statement:** "Language around progress on vaccines may be adjusted to indicate the slowing pace of vaccinations and/or risks of the delta variant. There is a hawkish risk that the statement is changed to reflect that the committee expects a near-term taper."
- **Press conference:** Citi wouldn't be surprised to see a "formal set of 'normalization principles' released following the meeting'", cf the plan for balance sheet reduction in June 2017.
- **Future action:** Taper announcement in Sep, beginning in Dec; proportional between Tsy and MBS ($10B Tsy /$5B MBS), completed in 8 months. Though several other permutations, including meeting-by-meeting decisions given uncertainty over the outlook.

Commerzbank: The Fed Is Not In A Hurry

- Commerzbank does not see the Fed giving a signal on reducing bond purchases, but "it is likely to push ahead with preparations and possibly present some ensuing considerations."
- **Statement:** Unchanged forward guidance.
- **Future action:** Fed to signal tapering in early fall, making decision in 4Q 2021.

Credit Agricole: All Bark And No Bite?

- Credit Agricole says there "still seems to be no consensus at the Fed on the need to reduce stimulus" given core leadership suggesting that a taper is still "a way off".
- They write that recent interactions with clients suggest "investors are expecting the Fed to stick with its patient approach. We therefore think that the bigger risk on the day would be a 'hawkish surprise' similar to the June policy meeting."
- This is due in part to recent data releases shifting the balance of risks in favor of policy normalization.

Credit Suisse: MBS Taper To Start Later This Year – Tsys To Follow

- Credit Suisse sees the July meeting as likely to be uneventful, "as the Fed continues to evaluate the mechanics and timing for tapering asset purchases."
- **Statement:** Should acknowledge that the labor market and inflation continued to pick up since the last meeting.

- **Press conference:** Powell likely to sound more cautious about upside inflation risks and suggest that the Fed is ready to respond in case there are signs of more persistent inflation or a concerning increase in inflation expectations – but will note that ‘substantial further progress’ remains a ways off.
- **Future action:** “Worrisome inflation and strong housing data” are likely to push the Fed to announce MBS taper by later this year, with Treasury reductions following in early 2022.

Danske: No Significant Changes

- Danske doesn’t expect the FOMC to make “significant changes” at the July meeting.
- Danske: “The Fed still thinks that high inflation is transitory and the labour market has still not fully recovered. Also it is one of the interim meetings without updated projections.”

Deutsche: Taper Strategy Session

- Deutsche expects “an update on the progress of [taper] discussions that will help refine the likely timeline for an announcement in the coming months” from the July FOMC meeting.
- More specifically, Deutsche sees the Committee discussing progress toward taper thresholds and to receive a technical briefing on timing/pace/composition.
- Possible that FOMC finally hammers out details for a standing repo facility.
- **Statement:** Few changes; however risks in both directions: more hawkish adjustment could put greater emphasis on recent inflation data (e.g. downplaying transitory factors / removing the requirement for “substantial” from “further progress”.); dovish would acknowledge downside risks from Delta Covid variant.
- **Press conference:** Powell to indicate that taper discussions to continue at upcoming meetings, but stopping short of a clear signal that tapering is imminent.
- Key topics: update on status of taper talks; latest inflation views; how FOMC is interpreting market moves, esp for bonds; how Delta variant is viewed as a risk.
- Re market moves: “We would expect the Chair to attribute lower yields to both technical and fundamental factors…but also downplaying the possible pessimistic signal about the growth outlook.”
- **Future action:** Clearer signal of tapering at Jackson Hole or Sep meeting, with official announcement in Nov. If June CPI surge motivates an acceleration in taper talk, we could get a clearer signal that tapering could be as early as Sep. Faster drawdown in MBS ($10B MBS/$10B Tsy) to start. Rate liftoff in 3Q 2023, 75bp of hikes in 2024.

Goldman Sachs: Still On Track For A December Taper Announcement

- Goldman sees the FOMC as “unlikely to deliver the first hint about tapering” at the July meeting - with Powell saying in mid-July that “substantial further progress” required for tapering remains “a ways off”, the spread of the Delta covid variant, and bond market expressing anxiety about the outlook.
- “Most of the FOMC is unlikely to see a need to accelerate the start date or pace of tapering at this point.”
- **Future action:** Taper hints in Sep and Nov, formal announcement in December ($10B Tsy / $5B MBS per meeting, last one Nov 2022). Rate hikes on the table ~ March 2023, with first hike in 3Q 2023.
- Fed to be reluctant to tweak MBS vs Tsy purchases, but if they do, could be $10B Tsy / $10B MBS pace.

HSBC: Tapering Timing Talk

- At the July meeting, HSBC expects the FOMC to “begin to tackle questions about the composition of tapering and how long it might last”.
- Payroll gains around or above an average 500k monthly in H2 would be enough to satisfy “substantial further progress” taper criteria.
- **Statement:** Changes to be relatively limited, could note that inflation has risen “further” since June, and perhaps also acknowledge that the sectors hardest-hit by the pandemic have shown further improvement.
- **Press conference:** Powell’s July congressional testimony provided a roadmap for what to expect.
- **Future action:** December taper announcement. On pace: if Fed were to announce a taper with a similar pattern as in 2014 (in this case, $5B/month each of MBS and Tsys), net MBS buys would conclude at end-October 2022, but net Tsy buys would still be ongoing.
- Re MBS vs Tsy taper, “Powell could address this issue in his press conference … and additional details could come with the minutes”.

ING: Fed To Bide Its Time

- ING writes that while the July meeting is likely to be a "non-event", they expect to hear Powell talk a little bit more about the discussions surrounding the path to tapering, with talk heating up at the Jackson Hole conference.
- ING believes inflation will be more persistent than implied by the Fed's forecasts, and notes re market conditions: "The fall in 10Y Yields from 1.7% to 1.25% is a big additional monetary stimulus…and is only likely to add to the nervousness of the more hawkish members."
- **Press conference: "**Powell is likely to suggest that while discussion on tapering has started, there is still plenty of time before they need to reach a conclusion on what they will do."
- **Future action:** Taper plan fleshed out in detail in Sep, formally announced in Dec, with relatively swift reduction that sees purchases end in 2Q 2022. Rate liftoff in Sep 2022, another hike in Dec 22022.

JPMorgan: Delta Variant Presents Downside Growth Risks

- JPM sees the July meeting as less eventful than June's "hawkishly-perceived" meeting.
- They note that Powell's July congressional testimony "raised the prospect that the FOMC statement would introduce an asymmetric policy bias: standing prepared to adjust policy if the Fed 'saw signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with our goal." So, JPM sees the increasing prevalence of the Delta Covid variant raising downside growth risks which "should help the doves argue for retaining the current symmetric policy bias".
- **Statement:** Description of the economy likely to note that activity has continued to strengthen, and observe that inflation has increased "notably". Unchanged wording around asset purchases.
- The "material and persistent" phrase on inflation Powell said in his congressional testimony isn't new – as it appeared in his June FOMC press conference prepared remarks – but in the testimony "it was reordered to give the impression that policy is now biased toward reacting to inflation risks. If this language were repeated in the statement it would represent a new, asymmetric risk bias."
- **Press conference:** Powell to relate that the Committee discussed tapering again and that the economy is slowly getting closer to passing the "substantial further progress" test to actually start tapering.
- Look for updates on FOMC's thinking about tapering in Powell's prepared remarks.
- After "a long way from" in April and "still a ways off" in June, Powell could say something like "still has further to go" before substantial further progress is met.
- **Future action:** December taper announcement.

Lloyds: Message To Be Largely Unchanged

- Lloyds sees rising uncertainty (on inflation and rising Covid cases globally, as well as falling yields) meaning the majority of Fed policymakers "will probably not want to do anything new" at the July FOMC, though they will probably not want to backtrack on June's message either.
- The key message will be that they are in wait-and-see mode.
- **Press conference:** Powell may say that the FOMC has now started to talk about when they should taper QE, but seems unlikely to provide further detail at this point.

Morgan Stanley: Talking Taper

- Morgan Stanley expects a "robust discussion" on tapering at the July meeting, with Powell likely to stress that no decision has yet been made.
- Even so, their strategists think the meeting "could be an important catalyst for higher yields", with risks "skewed toward an upbeat and hawkish message, especially compared to the relatively benign policy path in the price."
- MS believe that the details of tapering shouldn't take long to hammer out, having gone through a tapering process in the previous cycle.
- **Future action:** Forward guidance on how taper to proceed released in Sep, followed by official taper announcement in March 2022, effective April 2022 ($10B Tsy / $5B MBS), ending in 1Q 2023.
- Risks are to an earlier start and faster pace of MBS tapering.

NatWest: Wide-Ranging Taper Discussion

- NatWest expects a wide-ranging taper discussion by FOMC participants at the July meeting (with staff presenting potential options), but the most noteworthy news is likely from the press conference and in the minutes released in August.
- **Statement:** Only modest changes. Powell's line from his recent testimony "Inflation has increased notably and will likely remain elevated in coming months before moderating" could replace "Inflation has risen, largely reflecting transitory factors."
- Possibly could insert a reference to reflect the Delta Covid variant.
- **Press conference:** Powell's main message will be no rush to taper as "substantial further progress is still a ways off", but he will clearly remind that the taper countdown has officially begun.
- Powell to sound optimistic on labor market improvement, but remind that there is "still a long way to go", and will put slightly less emphasis on the inflation pickup being transitory.

Nomura: Tapering Discussions To Heat Up, But Without Significant Urgency

- While the FOMC will continue to talk on the technical aspects of tapering (timing, pace and composition in July), Nomura believes "the window for advance notice for a September announcement is likely closed at this point."
- With some participants acknowledging that the inflation part of "substantial further progress" has been met, Nomura believes taper timing depends more on NFP growth – skewing risks toward an earlier-than-expected taper announcement.
- **Statement:** May acknowledge the slower pace of vaccinations and recent pick-up in the pace of new case growth (some risk of changes to "Progress on vaccinations has reduced the spread of COVID-19 in the United States."). No significant changes to inflation or forward guidance language.
- **Press conference:** Powell likely to reiterate the Fed's view of transitory inflation, with upside risk, while potentially providing more guidance on the Committee's evaluation of "substantial further progress."
- **Future action:** December announcement, effective January (risks of a Nov announcement), running over ~12 months. MBS to be tapered proportionally more quickly ($8B per meeting vs $10B Tsy, ending MBS after June 2022, Tsy after Nov 2022).
- Rate liftoff Q2 2023, next one in Q4 2023.

Rabobank: Testing FAIT

- Rabobank notes Powell's language on inflation at the July congressional testimony, referring to taking action if inflation expectations move "materially and persistently beyond levels consistent with our goal"
- To Rabobank, "this suggests that Powell and his inner circle have become increasingly aware that – at least to the outside world – 'transitory' is just a baseline scenario and that it is useful to think what would make the Fed shift to an alternative scenario." I.e., inflation risks are seen to the upside.
- This language could find its way into the formal statement.
- **Future action:** Advance notice could come in Aug or Sep, with decision in 4Q (Dec meeting a "prime candidate"), starting in Jan 2022.

RBC: Low Expectations For Anything More Than A Glimpse Of Taper Talk

- RBC says the focus at the July meeting is "clearly" taper talk – but they "would be surprised if anything definitive comes from it", and are eyeing the minutes out in August for more detail.
- "In fact, we would set up low expectations for garnering anything more than a glimpse of the conversation that Powell is likely to say is 'ongoing' during the presser— or something to that effect."

SEB: Imbalances Between Supply And Demand

- SEB sees the key questions at this meeting as follows:
- "Will there be any new hints on tapering plans? How does the FOMC judge the imbalances between the supply and demand, and to what extent does the Fed continue to see current high inflation as transitory?"

Societe Generale: Thinking Of Tapering

- SocGen expects the FOMC to "continue to delve into taper discussions" at the July meeting. SocGen expects us to get "insights into the Fed's thinking on preferences around timing, pace and sequencing (MBS vs Treasuries)", as well as at upcoming meetings.
- While inflation progress has arguably been achieved, "with the US economy creating just over 500k jobs per month this year, we need at least a few months of consistent job gains for the Fed to feel comfortable about achieving tangible progress on employment."
- **Future action:** Nov or Dec taper announcement, effective early 2022, with gradual reduction.

TD: Easy Does It

- TD expects the FOMC "to have discussed a progress-dependent tapering plan at the [July] meeting while also emphasizing that actual tapering will require more progress than is evident thus far.
- **Statement:** The FOMC is likely to take first steps in the direction of "substantial further progress", with this line in the section on asset purchases: "While the conditions for beginning to reduce the pace of asset purchases have yet to be met, progress is expected to continue in coming months."
- "Could take the opportunity to flag the nascent Delta risk."
- **Press conference:** Powell to acknowledge ongoing FOMC discussions about tapering plans, but "substantial further progress" is still a "ways off". And the recovery remains on track despite the Delta covid variant, and the surge in inflation is "largely" transitory.
- **Future action:** December announcement (signaled well in advance), $10B Tsy / $5B MBS per meeting taper pace, concluding at the Nov meeting. First rate hike in Dec 2023.

Unicredit: too soon for a tapering signal

- The July FOMC meeting is too soon for a signal on the likely timing of tapering, writes Unicredit.
- This is for multiple reasons: there is a range of views on the FOMC regarding tapering and consensus will take time; most participants want more data; and there is no new SEP at the July meeting.
- **Future action:** Taper signal in Aug or Sep; announcement in December, starting in January 2022. The process will take one year or less, with $10B Tsy / $5B of MBS reductions per meeting / per month.
- A majority of the FOMC will prefer simplicity and not taper MBS earlier/faster.
- First rate hike in late 2023, with risks skewed to an earlier hike.

Wells Fargo: July Is All About Word Games

- Wells Fargo sees July's meeting as being "about word games", with "eyes and ears keenly attuned to signs that the FOMC may pull forward the eventual tapering of asset purchases, a topic it has already confirmed will be on the table."
- It will take time for the FOMC to see what it needs to see to pull the trigger on tapering: "we do not expect to get a decent read on how much childcare issues related to remote learning or the expiration of extra unemployment benefits are affecting the labor market until the October jobs report, which be published on November 5, two days after the November FOMC meeting concludes."
- **Future action:** Taper announcement in Dec, with reductions ($10B Tsy / $5B MBS) monthly starting Jan.
- Re MBS: "We suspect the FOMC would want to avoid the complication of a two-tiered taper, but the discomfort over supporting the housing market could pull forward the kickoff of what we expect to be an evenly paced tapering process between MBS and Treasury purchases."

Westpac: Waiting For Guidance

- Westpac doesn't expect much in terms of guidance on the outlook at the July FOMC – instead, they are looking to Jackson Hole and the Sep FOMC.
- **Future action:** Quick taper in 1H 2022 followed after a short delay by a sequence of rate hikes (up to 1.625% in 2024).

Wrightson ICAP: Likely To Settle On General Tapering Strategy

- The FOMC is likely to settle on a general tapering strategy at the July meeting, writes Wrightson ICAP.
- They believe the asset purchase program has “outlived [its] usefulness in every respect except one”: meeting prior commitments, which is important as fwd guidance has become a front-line tool for mon pol.
- **Press conference:** “should solidify market expectations that the FOMC will be positioned to consider a tapering announcement at any point from the fourth quarter onward.”
- **Future action:** More concrete taper guidance in September, pulling trigger “at some point shortly thereafter” (possibly November, which would be at the early range of market expectations).
- The Fed will reserve the right to adjust the pace of tapering in response to economic developments, but in practice it’s “highly likely” that it’ll play out on a predictable schedule (i.e. autopilot).
- Wrightson ICAP “suspects” the Fed may choose to wind down MBS buys faster than Tsys (“initial reductions of $10 billion in each of the two asset classes would eliminate MBS purchases within four meetings while leaving some residual Treasury purchases to linger at the end of the process”.
- Fed to avoid any new commitments about delaying rate liftoff until after taper is concluded; likely to reiterate that reinvestment likely to continue to a period of time after tapering. May ultimately decide to reinvest MBS principal in Tsys but “it doesn’t need to make that call this month”.

MNI Policy Team Insights

MNI INTERVIEW:Kaplan Ups PCE Outlook to 3.9%, Urges Taper Talk (Pub Jul 13, 2021)

By Evan Ryser

WASHINGTON (MNI) - Dallas Fed President Robert Kaplan told MNI Tuesday he has raised his inflation forecast for the remainder of the year and into 2022 on a significant widening of price pressures, and urged more debate on pulling back asset purchases.

"Our own view at the Dallas Fed is that PCE will end the year at approximately 3.9%, and that there's a second phase going on right now of a broadening or bleeding out of these initial extreme moves to a broader range of items," Kaplan said. The revised outlook is half a percentage point higher than Kaplan's previous estimate for this year and would mean no slowdown from the most recent report for May.

Overall PCE inflation will slow by the end of next year to about 2.5%, he said. Broader price gains are evidenced by the Dallas Fed's signature trimmed mean measure coming in at about the same pace at that time. "That is a pretty significant move," he said. "Even when you X out extreme moves, you're going to still see broad pricing pressures to the belly of the distribution."

While "not terribly surprised" by June's 13-year high 5.4% CPI inflation rate reported earlier on Tuesday, Kaplan repeated the need for the Fed to begin debating an end to its USD120 billion monthly asset purchases. Fed Chair Jerome Powell has resisted much of that debate this year, saying he's committed to underwriting a complete economic recovery.

'FRONT FOOT' ON TAPERING

"As we approach substantial further progress, I'm probably one who would be more on his front foot, and try to adjust these purchases sooner rather than later," he said. "These purchases are well suited to stimulating demand, but we really don't have a demand issue. We have very strong demand. We've got supply issues."

Kaplan wants a gradual taper and said he's saving "specific comments for the FOMC meeting," while emphasizing that an earlier taper does not imply an earlier interest-rate liftoff.

"People have been assuming if you discuss tapering sooner or you start tapering sooner, it has implications that maybe that means you're going to raise the fed funds rate sooner, he said. "I actually don't think that's accurate."

"If we can adjust our purchases sooner rather than later and avoid doing these purchases for longer than necessary, I think it actually will give us more latitude, if it's appropriate to be to be patient and to make decisions about the Fed funds rate down the road," he said. Kaplan hasn't made any judgement about whether there needs to be a fallow period between the end of tapering and rate hikes. Some Fed officials, such as New York Fed's John Williams who is also vice chair of the FOMC, have stated a preference for seeing an end to the process of drawing back on asset purchases before raising short-term interest rates.

JOB MARKET FRICTION

Kaplan, who isn't a voting member of the FOMC this year, forecasts a rate liftoff in 2022 from its current setting near zero, but "the timing of tapering is not influencing my thoughts on what I submitted on my SEP." He declined to elaborate on his 2023 rate projection, citing a focus on near-term conditions, continued uncertainty, and possibilities that inflation could come in under expectations.

Kaplan also said that while "the job market will continue to improve and recover," he said we "may not see the very strong headline job growth numbers that we might have expected of a million plus per month."

Fears of infections, supply-demand frictions, and over two million retirements since the onset of the virus will hold back the labor rebound, he said. Wages should continue to firm and will also be "a factor" for inflation, he said.

"I'm still hopeful that on the unemployment rate that we can get back to ultimately pre pandemic levels," Kaplan said, adding that the aging workforce means achieving pre-pandemic participation rates may be difficult.

"We are more skeptical about EPOP, and the degree of improvement necessarily you're going to get there," he said.

MNI: Fed Looking At 12-Month, Flexible Taper - Ex-Officials

(**Pub. Jun 25, 2021**)

By Jean Yung and Evan Ryser

WASHINGTON (MNI) - The Federal Reserve is probably looking at winding down its USD120 billion a month bond purchase program over 12 months, but could take a flexible approach as conditions change, with some officials lobbying for a faster reduction of mortgage bonds and some for a more rapid taper overall, former top policymakers told MNI.

A reduction of USD10 billion in Treasury purchases and USD5 billion in MBS per Fed meeting would be a "reasonable template" that would end purchases after eight meetings, or a year, in a similar fashion to that in which the Fed brought QE3 to a close., said former New York Fed President William Dudley.

"If you're generally satisfied with how it went last time, and I think they are, why not just follow the template unless they're a compelling reason to deviate?" he said.

HAWKS WANT FASTER TAPER

With Fed consensus building toward a year-end announcement on tapering, the FOMC will over the next several meetings hear staff briefings about the effects of the purchases and implications of different possible taper paths.

But already divisions are showing among those more optimistic about the speed of growth -- and pessimistic that higher inflation will prove transitory -- and others who see a more prolonged recovery. Seven of 18 FOMC members forecast lifting rates next year but there are five who still don't see a need to raise rates until after 2023.

The hawks will argue for a faster taper and options to speed up the process if inflation data comes in hot or to raise rates before the taper is complete. On the other hand, the economy could slow so much next year that disinflation resurfaces as a worry.

The heightened uncertainty over how the economy will finish out the Covid-19 recovery will also prompt the Fed to pledge to stand ready to adjust the pace of purchases if the outlook shifts, the ex-officials said.

"It really is going to be the case that it is not a smooth trajectory to zero with very low probability of deviating from that path," William English, former director of the division of monetary affairs at the Fed Board, told MNI. "That is the way that it turned out last time in 2013 because the economy continued to chug along as expected. Given the uncertainties, that may not happen this time."

A year-long taper without any special priority for mortgage-backed securities is a likely result, he added, but the Fed will be watching the economy closely and adjusting the pace if their fundamental view of the outlook changes.

UPSETTING THE APPLECART

Some FOMC members are eager to move to an all-Treasuries portfolio, given the booming mortgage market, but former officials told MNI the Fed leadership is hesitant to rock the boat and risk disruptions to a market accustomed to the Fed's presence.

"It just seems a little bit too much like tinkering with the innards of the economy to be doing it that way," said Steven Kamin, former director of the division of international finance at the Fed Board now a resident scholar at the American Enterprise Institute.

The FOMC has also argued that MBS purchases are not about supporting the housing market but more broadly help the economy by putting downward pressure on Treasuries and across the asset spectrum. To back away from that line of reasoning would be awkward.

"Even if it's the case that they don't taper MBS first, the fact that the rationale for MBS purchases is weak might mean that they'll lean toward tapering everything a little sooner rather than a little later," Kamin said.

Dudley agreed, saying there was no great argument to zero out MBS purchases any faster, despite the buoyant housing market.

"You've already established a template of how you do it, and last time you did them together," he said. "If you're going to do it differently this time, it raises questions like what else are you going to do different? So I'd be surprised if they do MBS first."

MNI INTERVIEW: Fed Could Delay Taper If Jobs Lag--Adviser (Pub Jul 6, 2021)

By Pedro Nicolaci da Costa

The Federal Reserve could wait longer than investors expect to begin reducing its QE program if gains in the employment-to-population ratio fail to pick up appreciably at the end of summer, New York Fed economic adviser Sebnem Kalemli-Ozcan told MNI.

"They are really focusing on the dual mandate here, they are really focused on the employment side and these kind of past experiences I think taught them that it's not that straightforward when you see inflation picking up a little bit that you're going to get back to full employment," Kalemli-Ozcan, an economics professor at the University of Maryland and a member of the New York Fed's economic advisory panel, said in an interview.

Wall Street believes the Fed will start slowing its monthly USD120 purchases of Treasury and mortgage bonds at the end of this year or early next year. But that scenario is contingent on the prospect that a recovery in employment and the size of the workforce, which have so far disappointed, will pick up appreciably after schools reopen in September and comfort with vaccination levels becomes more widespread.

The economy did generate a robust 850,000 new jobs in June, but the employment-to-population ratio, a key metric for Fed officials, did not budge from 58.0%, far short of a pre-crisis reading of 61.1%.

"The labor market is not fully back so the Fed will wait for that," Kalemli-Ozcan said after the report on Friday. "There are some structural changes going on that we do not fully understand," she added, pointing to the puzzle of a large number of open positions alongside reports of employers who can't find enough workers to hire.

Richmond Fed President Thomas Barkin told MNI in a webcast last week he would like to see further increases in the employment-to-population ratio before he can declare "substantial further progress" toward the Fed's full employment goal, an FOMC-designated prerequisite for tapering QE.

TANTRUM LESSONS

Kalemli-Ozcan said policymakers scarred by the experience of the 2013 taper tantrum are all too aware of the possibility of an adverse market reaction when the Fed does start reducing its bond buys, and will thus approach the process very gradually.

"If they are going to start changing this USD120 billion monthly purchases they are really going to clearly communicate that. This is the lesson from the May 2013 taper tantrum -- they are not going to make that mistake again," she said. "This is going to be slow."

Fed Chairman Jerome Powell's press conference this month provided a mini test run for the market's capacity to absorb hawkish surprises. He was forced to both deflect market concern about a moving forward of the Fed's own expectations for the timing of rate hikes as well as conceding policymakers have started "talking about talking about" the tapering process.

The level of caution embedded in Powell's language choice was itself a signal of just how deeply the Fed's desire to start tapering bond buys is conditional on robust additional employment gains.

"There are not going to be any surprises. A surprise in that would have even bigger ramifications than when interest rate liftoff is going to be because that is something that really helps to decrease risk spreads."

Powell largely passed his initial test as an early decline in equity prices and higher bond yields quickly reversed course but it remains to be seen how investors will react to actual news that a taper is imminent.

'WITH POWELL' ON TRANSITORY
Kalemli-Ozcan pushed back against recent concerns about a persistent spike in inflation due to a combination of strong monetary support and a proactive fiscal policy.

The worries were exacerbated by higher-than-expected readings, with the year-over-year consumer price index hitting 5% in May and the Fed's preferred PCE index rising 3.9%. Most Fed officials believe that number is likely to come down fairly quickly as post-Covid price adjustments subside, and Kalemli-Ozcan agrees.

"I am with Chairman Powell on this. I'm in the camp that this is going to be transitory," she said.

"This was not a financial crisis, it was a health shock and it affected sectors differently. So If we could not get to full employment with the previous shocks which were more straightforward, why do we think we'll immediately get to full employment now? It's going to take time."

To her point, Fed officials and market participants have curbed expectations for monthly employment gains down from 1 million or more earlier this year to around 500,000. The Labor Department will release the June jobs report Friday.

Kalemli-Ozcan said the Fed will likely try to finish the tapering process before it begins raising interest rates, a topic that's gaining increasing scrutiny.

"If they do end up doing these things at the same time -- hiking rates and tapering -- that is not going to be taken well by the markets for sure. But I don't believe they are going to do that," she said. "If markets start pricing in this expectation I think the Fed is going to be very clear in their communication that they are going to partition these things out and not do these things at the same time."

MNI: Ex-Fed Officials See Rate Liftoff Before Taper Ends (Pub Jun 23, 2021)

By Jean Yung

WASHINGTON (MNI) - The Federal Reserve is likely to raise interest rates before its bond-purchasing program is phased out completely if faced with uncomfortable levels of inflation, though its communication task will be simplified if it can finish tapering first, former top Fed officials told MNI.

Most investors presume the Fed would not raise rates while still buying Treasuries and agency mortgage-backed securities, based on the post-financial crisis playbook. But some former officials anticipate economic conditions will warrant interest rate increases as early as 2022 following a tapering decision to be delivered toward the end of this year, leaving little or no time separating the two processes.

"I can well see, and indeed expect, some movement on rates before they finish expanding the balance sheet," former Fed Vice Chair Alan Blinder said in an interview. "Finishing the taper before raising rates is the less likely option."

An announcement on tapering could come in September or November, followed by a rate hike in 2022 if growth keeps up at a rapid pace and inflation does not quickly ebb to 2%, Blinder said. Raising interest rates while still adding accommodation via the balance sheet would be "hard to explain, but it won't stop them," he said. "They'll say something like: We have a portfolio of instruments and we'll adjust them to the needs of the economy."

QE A SECONDARY TOOL

The Fed regards asset purchases as less precise and effective than interest rates, its most potent monetary policy tool, influencing the entire economy beyond certain financial intermediaries. Tapering would in its view be a fairly small move in terms of its overall policy settings.

It would not hesitate to raise rates while securities purchases still continued, should the committee deem that appropriate, despite the fact that QE makes most sense when rates are at zero, officials said.

Naturally it would be easier for the Fed to communicate its tightening policy if it is not still adding some accommodation via QE, but inflation may not allow it that luxury.

"We've got two not-very-precise dials we can turn, both of which modulate the amount of support to economic activity, and what matters is the overall amount of support monetary policy is providing, the combination of the two dials together," former Fed Board research director David Wilcox told MNI. "There's no reason to turn one to off before adjusting the other one."

SPEEDING UP TAPER

The timing of interest rate increases also has implications for the pace at which the Fed winds down its purchases, the former officials said. If the Fed needed to raise rates while still adding assets, it could consider speeding up its QE tapering, but the bar would be high.

"They've always treated asset purchases as a slow-moving object, simply to allow the market to better absorb the flow of Treasury sales and make things very predictable for market institutions," said former New York Fed research director Jamie McAndrews.

"They want to put securities on a predictable course, and if they need to remove accommodation, they could raise rates wherever they are in the tapering process."

The option to quicken the reduction of purchases is "very plausible" as well, depending on how much faster it would need to be, former Fed Governor Larry Meyer told MNI.

"It would be nice to end tapering before you hike rates, but it's not a requirement. When you meet the condition to lift off, you lift off. End of story."

MNI: Fed Inflation View Tested By Hot Streak, Ex-Officials Say

(**Pub. Jul 15, 2021**)

By Pedro Nicolaci da Costa and Jean Yung

MNI (Washington) - A run of surprisingly strong inflation readings is increasing the danger that the Federal Reserve could allow expectations for higher price increases to become entrenched unless it alters its policy stance, former Fed officials and staffers told MNI.

"The inflation numbers continue to come in significantly stronger than the Fed was expecting a few months ago -- stories about special factors are losing credibility," Jeffrey Lacker, former president of the Richmond Fed, said in an interview.

Consumer prices jumped 5.4% in June, a third month of higher-than-expected readings that raised fresh inflation concerns in financial markets and among some Fed officials, even if skyrocketing used car prices likely exaggerated the spike.

"Even though strong increases in several categories seemed to drive the headline numbers, the surge in this report is fairly broad," Lacker said.

Pressed on the issue of inflation during Congressional testimony this week, Fed Chair Jerome Powell stuck to the script that he expects recent increases to be largely transitory, pointing to used car prices that are likely to subside.

Still, the outsized nature of the rises, and what many see as their broadening nature, is giving some current and many former policymakers pause.

Dallas Fed President Robert Kaplan told MNI in an interview Tuesday that he was raising his own inflation forecast for this year and next given widening price pressures.

Against that backdrop, Powell was repeatedly asked during his semi-annual testimony on monetary policy as to why he was not more concerned about inflation or ready to act against it. He said the Fed needs more time -- around six months -- to look through recent price data that's muddied by comparisons to the depth of the pandemic, when prices plunged.

Charles Plosser, ex-president of the Philadelphia Fed, said the debate over temporary or permanent price pressures obscured the importance of how monetary policy reacts to those pressures.

"Policy needs to make sure that the temporary effects don't become more ingrained through rising expectations," Charles Plosser, ex-president of the Philadelphia Fed, told MNI.

"Monetary and fiscal policy are both very accommodative. This aggressiveness will be more important for future inflation than the bottlenecks or supply considerations that everyone seems focused on," Plosser said.

REACTION FUNCTION

In particular, the Fed's shift in framework into a stance that waits for persistent inflation to show up in the economy before any reaction, in contrast to a previously preemptive posture, complicates matters, Plosser said.

"The Fed is signaling it doesn't intend to change course any time soon as it seeks to achieve its inclusive employment objective," Plosser said.

"What happened in the 1970s was that monetary policy turned supply shock price increases into a more sustained inflation. The environment today seems remarkably similar."

Lacker also honed in on the framework shift as fundamentally altering the economy's inflation prospects.

"The thing that anchors inflation is expectations, and the Fed has deliberately tried to unanchor expectations with the framework," he said. "The news is filled with stories that, oh yes, they want to tolerate a little inflation above 2%, so everyone hears that and says, the Fed wants inflation above 2%."

Roberto Perli, a former Fed board economist, is still fairly sanguine about the prospect for inflation to come back to Earth. But he conceded recent readings would likely boost the Fed's own estimates.

"Higher inflation today, for whatever reason, raises the odds that inflation will stay higher at the end of the year, so an increase in the median 2021 inflation is very plausible in September," he told MNI.

Joseph Gagnon, another ex-board economist, told MNI he thinks the Fed will look through current readings but he's worried inflation will linger for longer than the core of the Federal Open Market Committee expects.

"I continue to predict more inflation in 2022 than almost anyone else," said Gagnon, who is forecasting 3% core inflation next year "with a wide confidence band."

The Fed is set to keep discussing when and how to begin reducing its USD120 billion monthly purchases of Treasury and mortgage bonds at its forthcoming meetings. Any discussion about interest rate increases is likely much further into the future, although some former officials believe a rate increase in 2022 is becoming inevitable.

MNI: Patience Warranted as Inflation to Ease -Ex-Fed Economists (Pub Jul 23, 2021)

By Evan Ryser

WASHINGTON (MNI) - The prospect of softer inflation readings over coming months and into early next year, reflected in a recent plunge in long-term bond yields, will likely give Federal Reserve officials greater room to wait for stronger employment growth before tightening policy, ex-Fed board economists told MNI.

Investors focused on a short-run spike in inflation may have missed a coming turning point, according to these staffers, whose views closely match those of Fed Chair Jerome Powell. Last week, Powell suggested policymakers need at least six more months to properly interpret data muddied by comparisons to the depths of Covid and by shifting labor market and supply chain trends.

"Inflation went faster to where we thought it was going to peak, and if that's the case, it can come down faster than we thought," Claudia Sahm, former Fed board economist and forecaster, said in an interview. "You could get (CPI) inflation back down to 3% by the end of the year, and start settling in at 2% by the middle of next year."

That would create breathing space for a central bank that has come under increasing pressure from investors and politicians to explain a sharper spike in consumer prices than expected, as the yearly gain in CPI hit 5.4% last month. The Fed's preferred PCE measure jumped to 3.9% in May.

"To the extent that today's inflation reflects a resurgence of demand, that inflation may well prove substantially temporary," David Wilcox, ex-director of the Fed board's Division of Research and Statistics, told MNI. "What we're seeing is a step-up of prices back to normal but little or no reason to expect further substantial changes either up or down from here forward."

As some supply chain constraints and other temporary bottlenecks are resolved, Wilcox said, "prices could decline, and in that case, today's rapid inflation could be replaced in some categories by substantial deflation and price declines."

Such expectations help explain a turn in bond markets that has seen 10-year Treasury yields plunge as low as 1.126% Tuesday, pointing to fears that growth -- and probably inflation -- has already peaked and is now slowing again.

WHAT GOES UP

Sahm said bringing down future forecasts for inflation based on higher-than-expected readings was common practice among Fed forecasting staff.

"If you get surprised on the upside with inflation, the first question is -- did we get the timing wrong?" she said.

"We thought used motor vehicle prices were going to moderate this month but they were going to stay high over the next couple of months, so did we just get those next couple of months right now? If that's what happened, that actually means you take down your forecast of inflation for those next two months."

A deceleration in inflation readings would buy the Fed time to wait for additional employment and workforce gains, which have so far disappointed despite growth rates not seen in decades.

"I'm on the side of the debate that thinks the current uptick in inflation is transitory," said Laurence Ball, former visiting scholar at the Fed Board and the Boston Fed. Ball said he's a "big believer" in measuring core inflation with the Cleveland Fed's weighted median inflation rate, which he noted has been quite stable at just over 2% for CPI.

"It filters out the effects of big increases in sectors such as used cars, airfares, and lodging," he said. "Inflation expectations are strongly anchored, so inflation will naturally return to the Fed's target without drastic action by the Fed."

Wilcox offered a similar view. "We don't have evidence yet that longer-term inflation expectations have moved above where they were in 2014 and 2015. It's reasonable to draw a conclusion that inflation expectations remain at levels broadly consistent with the Fed's 2% objective."

UNCERTAINTY BAND

This doesn't mean inflation concerns are gone for good. The ex-staffers emphasized uncertainty as the economy emerges from the Covid slump, whereas others have previously told MNI the Fed should change its policy stance or risk higher inflation expectations becoming entrenched.

Key factors remain to be determined in coming months. In last week's testimony Powell pointed to questions over the portion of recent retirements which turns out to be permanent, and to the extent that a shortage of childcare options proves an impediment to workforce participation.

"It is too early to tell, as the expected demand and prices have surpassed all expectations, whether this trend will continue or not," said Marcelle Chauvet, former senior research economist and policy adviser at the Atlanta Fed. “There are lots of adjustments going on in the labor markets, commodity markets, manufacturing industries – most of these adjustments are temporary, but there is a fraction that will be of a more permanent nature."

Expectations are high for a surge in workforce participation when schools reopen fully in the fall, although the Delta Covid variant is prompting fears of continuing disruption, particularly in regions with low vaccination rates.

The Fed's initial hopes for 1-million plus job gains have been curtailed to expectations of about a half a million per month. The Fed wants significant gains in the employment to population ratio before declaring substantial further progress has been achieved in the labor market, its criteria for paring back QE.

Sahm thinks the Fed could wait until as late as March 2022 to reduce bond buying, though market expectations center around an announcement later this year. "The calendar is not working in favor of tapering by the end of the year," Sahm said.

MNI INTERVIEW: 'High Probability' of 2022 Fed Hike
(Pub Jul 14, 2021)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - Mounting inflation pressures and soaring growth will likely force the Federal Reserve to raise interest rates sometime next year, well before the 2023 consensus implied by the central bank's own forecasts, ex-Fed researcher George Pennacchi told MNI.

"There's a high probability that we'll see rates hiked in 2022," Pennacchi, a former Cleveland Fed visiting scholar, said in an interview.

The first rate increase might even come early next year, he said, which would upend the Fed's desire to keep a distance between plans to taper bond buys and raise interest rates.

"At some point they're going to have to do both, reduce bond purchases as well as raise rates. It's going to depend on just how overheated the economy is."

Inflation readings over the last three months have been substantially higher than Fed officials and market participants had expected earlier in the year, with the consumer price index surging 5% in May and seen posting a similar gain for June.

Pennacchi, also an ex-visiting scholar at the New York Fed and one-time consultant to the central bank's Washington-based board of governors, believes inflation could register around 4.5% for this year as a whole and as high as 4% next year -- double the Fed's official target.

The central bank's June decision to raise the interest it pays on bank reserves was a sign that officials already recognize there's too money sloshing around in the financial system, he said.

"They mentioned that that was a technical change but in the sense that was the start of raising rates," he said. "The effective federal funds rate will now be higher than it was over the last few months. It was averaging below 10 basis points and now it's probably going to move up a little bit. So that's a very mild rise in rates already but it might be a testing of the waters."

The combination of a system in which the Fed pays interest on reserves, first implemented in the depths of the Great Recession, and a sharply expanded fiscal stimulus policy is potentially troublesome, added Pennacchi.

"If inflationary pressures do persist, and there is this need to raise rates it's going to be more expensive than it was in the past because the Fed is paying interest on reserves," he said. "The Fed is going to have to be paying interest on reserves that's less seigniorage that's going to be going into the Treasury. That could exaggerate the inflationary pressures."

FISCAL FACTORS

Echoing concerns expressed by a number of former and some current Fed staffers and advisers, Pennacchi said the shift in fiscal policy toward a much more proactive stance had fundamentally altered the inflation outlook in a way that the Fed's recent framework shift toward a more dovish pro-employment stance ignores.

"The surprise of the Biden administration is just how stimulative their proposals are in fiscal policy," he said. "It seems like in most of Washington there's just no thought about the size of deficits and debt and that's just going to create a lot of financing needs of the Treasury that the Fed is going to have to soak up."

That could complicate the process of tapering the current monthly pace of USD120 billion bond buys, which Wall Street sees taking place sometime in early 2022.

"The Fed is in some ways going to have to accommodate whatever fiscal policy ends up being implemented in terms of their bond purchases if they want to keep interest rates at some pre-specified level," he said. "We've been somewhat lucky up to this point that there's been strong demand for U.S. Treasuries but that may not go on forever."

Pennacchi said money market funds have become a captive but fickle buyer of government bonds whose liquidity has been shown to evaporate in times of stress.

"Money market funds have in some sense transformed from funds holding private securities like holding commercial paper to now just holding U.S.Treasuries and government securities. But I think that's fragile and we could easily see outflows at some point."

MNI INTERVIEW: Fed Might Need to Hike in 2022, Hoenig Says (Pub Jun 18, 2021)

By Pedro Nicolaci da Costa

WASHINGTON (MNI) - Building price pressures could force the Federal Reserve to raise interest rates next year, well before its latest projections indicate, ex-Kansas City Fed President Thomas Hoenig told MNI, adding the central bank feels under pressure to maintain a dovish stance.

"To think that you wouldn't have a move until 2023 to me is almost not credible," said Hoenig in an interview. "Conditions might be such that the market may force them. If inflation continues then bond yields will begin to rise again."

The Fed surprised markets this week with a shift in officials' projections for rate increases that was more hawkish than the March forecasts and more aggressive than most participants had expected given previous Fed messaging. While the shift toward a median 2023 liftoff in interest rates to as high as 0.6% from their near-zero levels unnerved investors in itself, the transition of so many dots into 2022 and 2023 also showed just how quickly rate views can change based on a couple of months of data.

"The dots are short-term in nature -- people change their views based on the most recent data," Hoenig said.

The Fed was until recently convinced that inflation might spike for a couple of months and would quickly come back down to its 2% target. But after two months of readings well above forecast, including a CPI print of 5% for May, the Fed has conceded its preferred PCE measure will run hot at 3.4% this year.

"If inflation gets really wild you're going to have to really accelerate and then that's going to be huge -- that's a Volcker move," Hoenig said. "Here you have a chance to avoid it but they're not going to upset the apple cart."

THINK ABOUT IT
The Fed's reluctance to even entertain the debate about tapering its monthly USD120 billion in bond buys before this week's meeting is a sign of strong political and market pressures against any policy tightening, Hoenig said.

Until Wednesday, Fed Chair Jerome Powell had repeatedly stated officials were not even "thinking about thinking about" reducing QE.

"I really do think there's a concern about upsetting the market, I think there's concern about upsetting the Congress, there's a concern about upsetting the administration," said Hoenig. "It doesn't make sense. This is the job and they're going to say, we're not going to talk about it?"

Hoenig said the shift toward a more active fiscal policy under the Biden administration, which has already delivered USD6 trillion in support and is now pushing a broad infrastructure package, has significantly altered the economic outlook. But the Fed has stuck to its new, more dovish policy framework and made too few adjustments to its rhetoric about possible inflation risks, he added.

"They're waiting to be forced to do something. And if you wait, you're always going to be reactive, you're always going to be behind the curve," he said. "I'm worried about inflation, yes, but I'm also worried about the continued misallocation of resources that's going on."

'HELL OF A JOB'

The size of the budget deficit makes it inherently more difficult for the Fed to reduce its bond purchases, Hoenig said, raising concerns about fiscal dominance.

"If you start to taper when that stuff is coming up, interest rates are going to go up," he said. "Tapering is going to be one hell of a job to get done."

In addition, employment has not picked up as quickly as Fed officials had hoped earlier in the year, when Powell talked about wanting to see a string of monthly job gains around the 1 million mark after March showed 916,000 new hires. Since then, the March reading was revised down to 785,000 while April came in at just 278,000. May jobs rose 559,000.

Hoenig said this points to deeper problems of labor mismatch that could take a while to resolve but have little to do with borrowing costs.

"If employers are seeking 9 million openings and you're filling only 500,000 a month, that's a structural problem that I don't think monetary policy can fix," he said. "So if you wait for that to come down you're going to have a lot of inflation before it does."

MNI INTERVIEW:Fed Seen Trapped Near Zero After Biden Trillions (Pub. Jul 21, 2021)

By Evan Ryser

WASHINGTON (MNI) - A likely rise in the U.S. neutral interest rate driven by productivity gains and trillions of dollars in fiscal stimulus will be insufficient to prevent the Federal Reserve from returning to zero nominal rates in the next downturn, Kathryn Holston, who worked with New York Fed President John Williams in this area, told MNI.

Being stuck near zero "is something that we are going to have to contend with in future crises, unless we see a meaningful rise in the natural rate of interest, which is not something that I am expecting at present in any significant way," she said. "Fiscal spending could lead to a higher natural rate," said Holston, who worked with Williams as a Fed research assistant.

The so-called neutral rate of interest, also known as r-star, has been stuck near zero since the pandemic. Lately Fed officials have moved to open discussions about tapering asset purchases and pencil in rate hikes in the next few years with stimulus underpinning the fastest growth in decades.

Fed officials have sounded optimistic that recent productivity gains that would lift the neutral rate could last longer, but r-star is also influenced by demographics, inequality, savings rates, and demand for safe assets. Some of those forces together may keep downward pressure on rates despite President Joe Biden's spending push, Holston said.

NEUTRAL RATE BOUNCE

"We have these longer term factors pushing the natural rate down," she said. "If something like fiscal stimulus is pushing it up, it's still unclear what the end result is going to be."

Fed officials have said for years that demographics and population aging are secular factors in low rates and have adjusted by revamping their operating framework to average inflation targeting. Mary Daly of the San Francisco Fed recently warned climate change could also drag neutral rates lower by increasing consumers' precautionary savings and by hurting productivity.

The FOMC's own short-run r-star, issued quarterly in the Summary of Economic Projections, fell to a new low in June 2019, to 0.5% from 0.8%, and has remained there since throughout the pandemic. That means including inflation the Fed would likely raise the fed funds rate only as high as 2.5% to get to neutral, unless the central bank needs to cut down inflation momentum or the neutral rate continues to increase.

Some Fed high-frequency estimates put r-star at a record low in 2020 near -0.5%, while forecasts generated by the New York Fed show the real natural rate of interest increasing to 0% by the end of 2021 before rising to about 0.6% by 2024.

QUESTION OF PERMANENCY

Williams told reporters last week in response to a question from MNI that "hopefully as the economy gets back closer to full employment and as we get through that really unusual stage of Covid, we can revisit the model estimates" of r-star in a "few more quarters." Speaking months before Covid hit the U.S., Williams said he expected r-star to continue to move lower on demographic trends.

The NY Fed's estimates "end up with very similar results as ours, starting from a different model," said Holston, who is now an economist with the World Bank.

"Whether it's productivity changes, whether it's fiscal policy, in a longer term sense, it's going to depend on how permanent these changes are," she said.