

# MNI Fed Review: December 2021

## MNI View: March Is Live

By Tim Cooper

- The FOMC signalled its intentions to hike rates multiple times in 2022 in the face of inflation pressures.
- The doubling of the taper pace and Powell's comments keep the door open to rate liftoff as early as March.
- While the 2023-24 "dot" rate hike pace is seen as moderate, attention is already turning to Fed balance sheet reduction.

**Taper Doubled, And 2022 Hike Signalled:** The FOMC decided to double the pace of asset purchase tapering at its December meeting, to \$30B/month – which would bring net asset purchases to an end by March 2022 (vs June previously). That was exactly as expected and clearly signposted in advance. The question was to what degree this decision would be coupled with a signal for rate liftoff intentions. In that regard the 2022 dots were hawkish, showing a median of 3 hikes – only one sell-side analyst (JPMorgan) saw that as opposed to the broad consensus of 2 hikes. Nobody on the FOMC sees rates on hold in 2022 (vs 9 last time). This is a major change versus the previous quarterly projection in which the Committee was split between seeing rate hikes start in 2022 or 2023, and it brings the Fed's projections more closely in line to market pricing.

**March Meeting Is In Play For A Hike:** The 3 dots are seen by most analysts as implying a June, September, December hike sequence in 2022, with a bit of time between taper's end and the first hike. But faster progress on employment (the FOMC said in the statement it's already met the inflation side of the liftoff criteria) could get them there earlier than June (Powell said the economy was "making rapid progress" toward max employment), as could more above-expected inflation prints were they to augur "entrenched" inflation/expectations. Powell also implied that the labor market criteria for liftoff had been become less stringent, downplaying the requirement for a return to pre-pandemic labor force participation rates for instance. This points to an easing of the Fed's previously "stringent" standards on labor market recovery, and could theoretically be met early in 2022. While the previous cycle saw an extended gap between taper-end and liftoff, Powell said that while the FOMC didn't decide on that at this meeting, "I don't foresee that there would be that kind of very extended wait at this time. The economy is so much stronger." Therefore, the April 27-28, or indeed the Mar 16-17 FOMC meetings, should be considered "in play".

**Dots Hiking Pace Less Steep:** It's clear the FOMC intends to hike multiple times in 2022, but the path thereafter is not particularly steep. While only 2 on the FOMC see the end-2023 rate below 1.375% (vs last time when 15 of 18 saw rates below 1.375%), the overall path of rate hikes beyond 2022 is relatively gradual. The dots foresee 3 hikes in 2023 and 2 more in 2024 – as opposed to a hike-per-quarter schedule which some had expected. This means that the 2024 median of 2.1% is well below the 2.5% long-run dot. True, there are 5 who see the 2024 end-year Funds rate above 2.5% (vs just 1 last time who saw the 2024 rate above 2.125%), but it's likely the leadership of the FOMC belongs among the dots at 2.125% or below.

2022			2023			2024			Longer Run		
Rate	Sept Dots	Dec Dots	Rate	Sept Dots	Dec Dots	Rate	Sept Dots	Dec Dots	Rate	Sept Dots	Dec Dots
1.125	0	2	2.125	0	3	3.125	0	1	3.00	2	2
0.875	0	10	1.875	0	5	2.875	0	4	2.75		
0.625	3	5	1.625	3	3	2.625	1	0	2.50	9	9
0.375	6	1	1.375	0	5	2.375	0	2	2.38	1	1
0.125	9	0	1.125	6	2	2.25	0	1	2.25	4	4
			0.875	1		2.125	6	5	2.00	1	1
			0.625	3		1.875	1	5			
			0.375	4		1.625	2				
			0.125	1		1.375	0				
						1.125	3				
						0.875	3				
						0.625	1				

**Transitory No Longer In Name, But Remains In Expectation:** The statement eliminated the word "transitory" as expected - tweaking language describing how "supply and demand imbalances related to the pandemic and the

reopening of the economy have continued to contribute to the elevated levels of inflation" (getting rid of the reference to the elevation of inflation reflecting factors "expected to be transitory"). But the Fed's economic projections continue to suggest that inflation will subside in 2023-24 (2.2% avg core PCE) after remaining elevated in 2021 and 2022 (4.4% vs 3.7%, and 2.7% vs 2.3% respectively in previous projections). And Powell noted "broad expectation" that inflation would fall. Though he said the Fed would not "act as though that's a certainty", and pointed out that risks lie to the upside.

**SEP Suggests FOMC Sees Front-Loading Hikes Enough To Combat Inflation:** Powell noted that both expected rate hikes and easing Covid-related supply bottlenecks would contribute to subsiding inflation. With the usual caveat that the SEP is not a central Fed forecast, the descending path of core PCE inflation to 2.1% by 2024, combined with the "flattener" dot plot, suggests that the story is one of FOMC participants expecting front-loaded hikes being sufficient to stave off inflationary pressures. That's without having to even get close to the long-run rate. For their part, market-implied breakevens have remained steady since the decision, suggesting there's not much concern that the FOMC's suggested path will let inflation run rampant.

**Balance Sheet Runoff Already In Play:** Powell said the FOMC discussed balance sheet runoff this week, and would it again discuss at the January meeting and "I suspect" in March. He said that "we looked back at what happened in the last cycle, and people thought that was interesting and informative, and but to one degree or another people noted that this is just a different situation, and those differences should inform the decisions we make about the balance sheet this time." In the last cycle, the FOMC rate liftoff was in December 2015, and balance sheet normalization started only in October 2017. Powell's comments suggest initiating runoff is not likely to take as long this time as it did in the previous cycle, and we'd interpret that to mean a decision could be made even by end-2022. We may get a little more clarity on Jan 5 with the meeting minutes release, but the deliberations have probably only just begun, and this will be a key market focus early next year.

## FED: FOMC Instant Answers

- Is the taper pace accelerated? What is the new pace? **YES. Taper doubled to \$30B per month.**
- Will the faster taper start in January? **YES**
- Does the Fed explicitly mention the taper ending in March? **NO**
- Median projection of Fed funds at the end of 2022/2023/2024/Long Run? **0.9% (2022); 1.6% (2023); 2.1% (2024). 2.5% (longer run).**
- Median core PCE inflation in 2022/2023? **2.7% (2022); 2.3% (2023).**
- How many 2022 dots are above (not equal to) 0.625%? Above 0.875%? **12 dots above 0.625% (vs zero in September SEP). 2 dots above 0.875%.**
- How many 2023 are above (not equal to) 1.375%? **11 dots (vs 3 in September SEP).**
- Any dissents to the decision? **NO**

## FOMC Links:

- **Statement:** <https://www.federalreserve.gov/newsevents/pressreleases/monetary20211215a.htm>
- **Summary of Econ Proj:** <https://www.federalreserve.gov/monetarypolicy/fomcproptabl20211215.htm>
- **Implementation note:** <https://www.federalreserve.gov/newsevents/pressreleases/monetary20211215a1.htm>
- **Press Conference Transcript:** <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20211215.pdf>

## MNI POLICY TEAM STATE OF PLAY

### Fed Flags Potential Rate Liftoff In Spring

By Evan Ryser

**MNI (Washington)** - The Federal Reserve on Wednesday announced a faster end to pandemic-era bond purchases coming in March and signaled an interest-rate liftoff is on the table to come soon after, shifting focus to stubborn inflation while moving closer to maximum employment.

"Moving forward the end of our taper by a few months is really an appropriate thing to do and I think Omicron doesn't really have much to do with that," Chair Jerome Powell told reporters after the December FOMC meeting, expressing confidence the Covid-19 variant will not derail expected rapid U.S. growth. The USD30 billion per month wind-down of the monthly asset purchase program starting in January would end the program in mid-March.

Powell said no decision has been taken on whether the Fed should pause between the end of taper and the first rate hike but there "will not be a need for a long delay" between the two. The FOMC's dot plot saw three interest rate increases in 2022, three more in 2023, and only two in 2024.

The FOMC's post-meeting statement provided adjusted forward guidance on short-term interest rates, dropping prior language on the desire to see higher inflation. Instead the Fed put more emphasis on employment, saying interest rates will remain at zero "until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment."

"We are making rapid progress toward maximum employment," Powell said, adding the Fed could decide to hike before reaching maximum employment if inflation continues to rise more than expected. One disappointment has been lagging labor force participation, he said. The Fed now sees unemployment falling from 4.2% now to 3.5% next year and staying there through 2024.

#### --LINGERING INFLATION, ASSET RUN-OFF

The statement also dropped the term "transitory" in describing inflation. "Supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation" the Fed said in its statement, as MNI reported was likely.

Supply bottlenecks and shortages "have been larger and longer lasting than anticipated, exacerbated by waves of the virus," Powell said. Inflation will remain well above the central bank's 2% target "well into next year" in the Fed's view.

The FOMC also discussed runoff of the central bank's assets, Powell said. "We did have a balance sheet discussion, a preliminary discussion," he said about the December meeting. "And I expect we will have another at the next meeting and another at the next meeting."

"We looked back at what happened in the last cycle and people thought that was interesting and informative, but to one degree or another people noted that this is just a different situation," he said, noting a much stronger recovery now. "Those differences should inform the decisions we make about the balance sheet this time." Some analysts took this as a sign the central bank will allow maturing assets to roll off the balance sheet.

We "haven't made any decisions at all about when runoff would start in relation to when either liftoff happens or the end of the taper but those are exactly the situations we'll be turning to in coming meetings," he said. The Fed's balance sheet has grown to USD8.7 trillion from USD4.2 trillion.

## Analysts' Key Comments

### BNP: Risk Of Liftoff Before June

BNP stick with their call for rate liftoff in June but see a risk of it coming earlier.

- The Dec FOMC “rubberstamped the hawkish shift made by Chair Powell two weeks ago and completed the turnaround in the Fed’s inflation narrative” with inflation projections and the 2022 dots on the hawkish side.
- The Fed downplayed the Omicron variant threat with projections that imply the expected tightening won’t materially dent the economy, but the Fed might have to become more cautious if Omicron proves a bigger headwind.
- “We stick with our view for a June lift-off, not least due the likely near-term drag from Omicron, but risks are clearly skewed towards an earlier move”.
- “Either way, we expect the Fed to deliver more cumulative tightening than is currently priced into US rates markets”.
- BNP expect QT to start in Mar 2023 with risks of an even earlier move.

### Deutsche: This Time Is Different

Deutsche saw the primary takeaway from the press conference as “this time is different for Fed tightening, which is likely to be more compressed relative to the last cycle”.

- To sum up, “the economic picture has changed enough for the Fed not to want to fall too far behind the curve.”
- Several aspects of the Powell press conference “pointed to a Chair and Committee that could well be leaning towards more near-term tightening that is signaled in their latest SEP”, including the speed of labor market improvement, the need to act before inflation / expectations become entrenched / inflation risk management; lower bar for meeting the maximum employment threshold for liftoff.
- Deutsche sees risks that QT begins next year. “Powell’s comments indicated the same conditions that argue for a condensed timeline for rate hikes could also imply an earlier start to a passive unwind of the portfolio.”

### JPM: Fed Broadly As We Expected

JPM, one of the most hawkish views sampled in MNI’s Fed preview (and the only to expect 3 hikes in the 2022 dots), sticks with its call for a June liftoff and 3 hikes in 2022.

- Asset purchases are set to end by March after the pace of tapering was doubled, as widely expected.
- The median dot now looks for 3 hikes in 2022, but the pace of rate hikes doesn’t pick up from there and in fact slows to 2 in 2024.
- Notably, “even the most hawkish participant has just four hikes next year, and only a handful see rates ever getting even modestly restrictive”.
- The median projection is 2-1/8% by end-2024, still below the Fed’s 2.5% estimate of neutral.
- While there was a pivot between Nov and Dec, “the projections indicate they do not feel policy needs to be adjusted rapidly”.
- The revisions to the economic forecasts were largely in line with expectations, with notably lower unemployment and higher inflation this year and next.
- “The near-term signal about policy intentions was close to expectation, affirming they are pointing toward liftoff sometime in Q2-Q3 (we continue to expect the first hike in June)”.

### Morgan Stanley: Sticking With Q3 2022 Liftoff

Morgan Stanley sticks with its call for 2 hikes in 2022, starting Q3, despite the Fed dots showing a median 3 hikes.

- With taper now set to end in mid-March, the Fed has optionality to begin hiking soon after “should conditions warrant”. “That decision will be taken “in coming meetings”, which puts June in play, one quarter earlier than our call for 3Q22 liftoff”.
- This was acknowledged by a “marked hawkish shift” in the dots to a median 3 hikes in 2022 on the back of higher for longer inflation and “rapidly” strengthening labour market conditions.



- "Even after an upward revision to inflation, the FOMC sees risks to the upside". However, the MS call for liftoff in 3Q22 is tied importantly to their forecast that "core inflation begins to cool from February next year, providing the Fed with more breathing room after the taper ends".
- The Fed indicated it can be highly flexible ahead: "Powell emphasized differences between the strength of this cycle vs. last, which we think means there is no playbook for how long the Fed waits to hike after tapering ends".
- The same is true re the timing of balance sheet reduction, with further details still expected early next year.

#### **RBC: A Different Path To The Same Dec 2023 Rate**

RBC acknowledge risks to their call for 2 hikes in 2022 but see the same cumulative 6 hikes by end-2023.

- The Fed delivered its expected hawkish tilt and more, "looking past Omicron uncertainty and unveiling a surprisingly hawkish dot plot that shows most committee members expect 3 rate hikes next year".
- That is above RBC's forecast for 2 hikes in 2022 and slightly ahead of what was priced beforehand, notable in contrast to elsewhere where rate hike expectations are well ahead of central bank guidance.
- Faster taper "clearly opens the door to a Q2 rate hike rather than the Q3 liftoff we've been expecting".
- Inflation developments and an improving labour market backdrop were behind the decision to accelerate taper, a "particularly remarkable" pivot given the cautiousness in laying the tapering groundwork.
- Chair Powell noted the "rapid progress toward maximum employment" and all committee members see that test being met next year.
- However, "while today's hawkish tone suggests clear risk of earlier liftoff than we've been anticipating, the 150 bps of rate hikes we expect in the next two years aligns with the committee's median".

#### **TD: Dovish No More**

TD, the most dovish view sampled in our Fed preview, has pulled forward rate liftoff from Mar 2023 to Jun 2022 and sees 3 hikes in 2022.

- The dot plot surprised with a 75bp increase in 2022, (from 12.5bp in Sep) vs the 50bp that both TD and consensus had expected.
- This came on "sizable upward revisions to inflation projections, with officials still seeing upside risks".
- Further, Powell made clear that views on 'maximum employment' have evolved, "and that officials are ready to start raising rates well before the labor market returns to its pre-COVID state".
- "We changed our forecast to show rate hikes starting in June 2022, instead of March 2023. We expect a 25bp hike in June, followed by 25bp hikes in September and December as well".
- They also expect balance sheet runoff to start in Mar 2023, when the target range is 0.75-1.0% rather than waiting for 1-1.25% in the last cycle.
- TD notes that "while the front-end is priced for hikes by mid-year, we think long-end rates are too low" and remain short 10y real rates. They see a favorable cyclical profile for USD.

# Dot Plot / Econ Projections Comparison

Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy. Source: Federal Reserve

## DECEMBER 2021 FOMC:

Percent

Variable	Median <sup>1</sup>					Central Tendency <sup>2</sup>					Range <sup>3</sup>				
	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run
Change in real GDP	5.5	4.0	2.2	2.0	1.8	5.5	3.6-4.5	2.0-2.5	1.8-2.0	1.8-2.0	5.3-5.8	3.2-4.6	1.8-2.8	1.7-2.3	1.6-2.2
September projection	5.9	3.8	2.5	2.0	1.8	5.8-6.0	3.4-4.5	2.2-2.5	2.0-2.2	1.8-2.0	5.5-6.3	3.1-4.9	1.8-3.0	1.8-2.5	1.6-2.2
Unemployment rate	4.3	3.5	3.5	3.5	4.0	4.2-4.3	3.4-3.7	3.2-3.6	3.2-3.7	3.8-4.2	4.0-4.4	3.0-4.0	2.8-4.0	3.1-4.0	3.5-4.3
September projection	4.8	3.8	3.5	3.5	4.0	4.6-4.8	3.6-4.0	3.3-3.7	3.3-3.6	3.8-4.3	4.5-5.1	3.0-4.0	2.8-4.0	3.0-4.0	3.5-4.5
PCE inflation	5.3	2.6	2.3	2.1	2.0	5.3-5.4	2.2-3.0	2.1-2.5	2.0-2.2	2.0	5.3-5.5	2.0-3.2	2.0-2.5	2.0-2.2	2.0
September projection	4.2	2.2	2.2	2.1	2.0	4.0-4.3	2.0-2.5	2.0-2.3	2.0-2.2	2.0	3.4-4.4	1.7-3.0	1.9-2.4	2.0-2.3	2.0
Core PCE inflation <sup>4</sup>	4.4	2.7	2.3	2.1		4.4	2.5-3.0	2.1-2.4	2.0-2.2		4.4-4.5	2.4-3.2	2.0-2.5	2.0-2.3	
September projection	3.7	2.3	2.2	2.1		3.6-3.8	2.0-2.5	2.0-2.3	2.0-2.2		3.5-4.2	1.9-2.8	2.0-2.3	2.0-2.4	
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.9	1.6	2.1	2.5	0.1	0.6-0.9	1.4-1.9	1.9-2.9	2.3-2.5	0.1	0.4-1.1	1.1-2.1	1.9-3.1	2.0-3.0
September projection	0.1	0.3	1.0	1.8	2.5	0.1	0.1-0.4	0.4-1.1	0.9-2.1	2.3-2.5	0.1	0.1-0.6	0.1-1.6	0.6-2.6	2.0-3.0

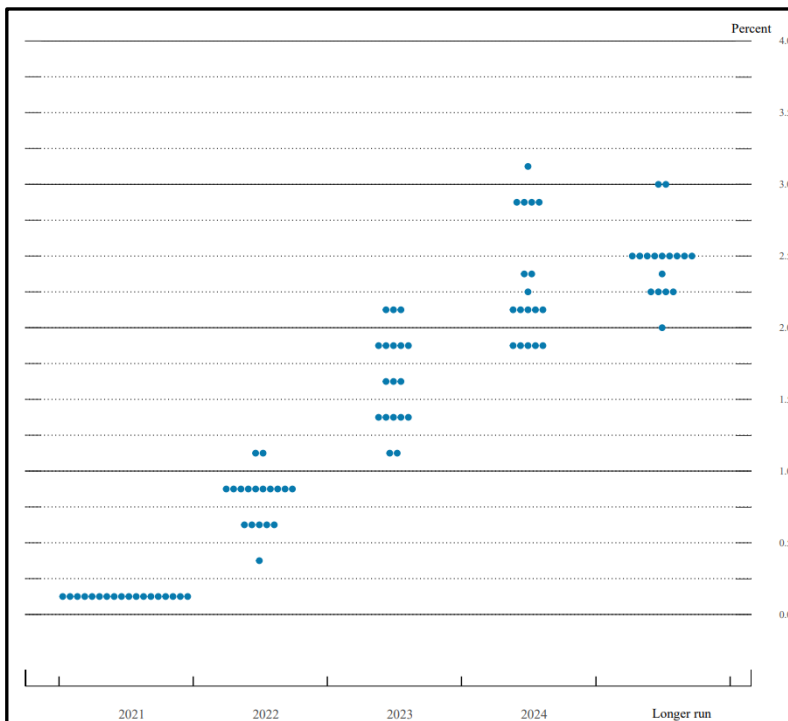
## SEPTEMBER 2021 FOMC:

Percent

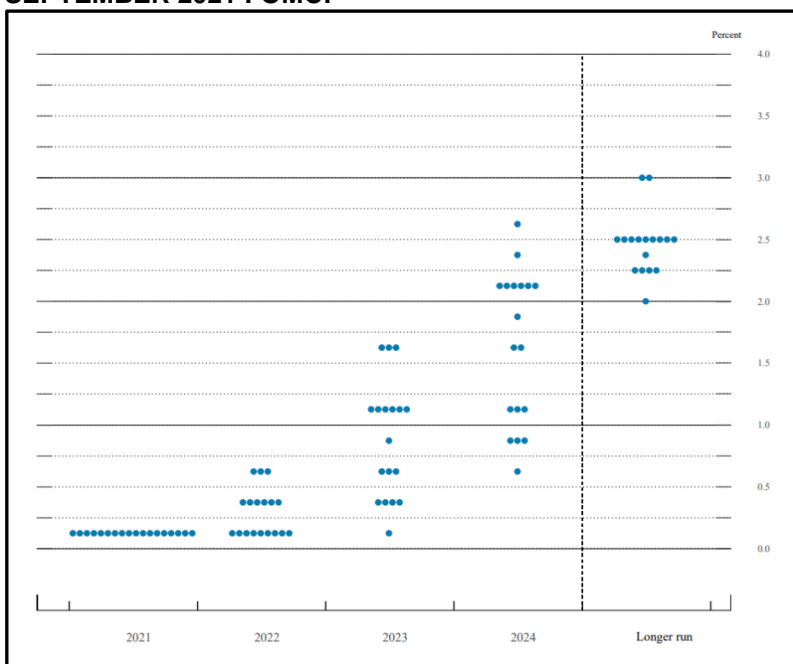
Variable	Median <sup>1</sup>					Central Tendency <sup>2</sup>					Range <sup>3</sup>				
	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run
Change in real GDP	5.9	3.8	2.5	2.0	1.8	5.8-6.0	3.4-4.5	2.2-2.5	2.0-2.2	1.8-2.0	5.5-6.3	3.1-4.9	1.8-3.0	1.8-2.5	1.6-2.2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

Participants' assessments of appropriate monetary policy:  
Midpoint of target range or target level for the federal funds rate. Source: Federal Reserve

DECEMBER 2021 FOMC:



SEPTEMBER 2021 FOMC:



## Press Conference Highlights

**As live-reported by MNI Analysts and Policy Reporters on our MainWire, Edge and Bullets services (transcript may not exactly match what was said).**

**On maximum employment:** Powell says they look at a "broad range of indicators" including unemp rate, labor force participation, job openings, wages,... also broadly and inclusively at different demographic groups and not just at the headline and aggregate numbers - "so that's a judgment for the Committee to make". "it is admittedly a judgment call because it's a range of factors, unlike inflation where we have one number that sort of dominates. It's a broad range of things."

**On time between taper ending and rate liftoff:** "We haven't made any decision of that nature, I wouldn't say that's our position at all. We did talk today about the balance sheet and we went through the way the sequence of events regarding the runoff and I think people thought that was an interesting discussion. They thought that it was informative but people pointed out that this is a significantly different economic situation that we have at the current time. The difference that we see now would tend to influence how we think about the balance sheet, and the same thing would be true about raising rates. I don't foresee that there would be that kind of very extended wait at this time. The economy is so much stronger. I was here at the Fed when we lifted off last time and the economy is so much stronger now, so much closer to full employment. Inflation is running well above target and growth is well above potential. There wouldn't be the need for that kind of long delay. Having said that, we'll make this decision in coming meetings. It's not a decision that the Committee has really focused on yet."

**On his view of maximum employment:** "We're not going back to the same economy we had in February 2020, and early on that was the sense was that's where we were headed. The post-pandemic labor market and the economy in general will be different, and the maximum level of employment that's consistent with price stability evolves over time within a business cycle and over a longer period, in part reflecting evolution of the factors that affect labor supply, including those from the pandemic." [Powell goes on to say that though unemployment rate has been dropping very quickly, labor force participation has been disappointing.] "It feels likely now that the return to higher participation is going to take longer...the reality is, we don't have a strong labor force participation recovery yet, and we may not have it for some time. At the same time we have to make policy now, and inflation is well above target, so this is something we need to take into account."

**On inflation risks:** "There's a real risk now, we believe, that inflation may be more persistent and that may be putting inflation expectations under pressure, and that the risk of higher inflation becoming entrenched has increased. It's certainly increased. I don't think it's high at this moment, but I think it's increased, and I think that's part of the reason behind our move today - is to put ourselves in a position to be able to deal with that risk and I think we are in a position to deal with that risk."

**On inflation risks to maximum employment:** "It might be one of the two big threats to getting back to maximum employment is actually high inflation ... the evidence grows that it's going to take some time, and what we need is another long expansion,...that's what it would really take to get back to the kind of labor market we'd like to see and to have that happen we need to make sure that we maintain price stability."

**On Omicron risks:** "I think there's a lot of uncertainty which is why we called it out in our statement our post-meeting statement as a risk...we're a long way from knowing what [the economic impact] will turn out to be."

- **Press Conference Transcript:** <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20211215.pdf>