

U.S. FOMC Review

- FOMC: tapering underway; inflation still viewed as transitory...
...but it depends on the definition of transitory

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The November FOMC Meeting

As widely expected the Federal Open Market Committee announced its plans to begin tapering its asset purchase program, beginning this month with reductions of \$10 billion of Treasury securities and \$5 billion of mortgage-backed securities. The Fed, in its current monthly cycle, will buy \$70 billion of Treasuries and \$35 billion MBS. The trading desk at the New York Fed has been operating on a purchase schedule that runs from mid-month to mid-month. Thus, the \$70/\$35 billion of purchases runs from mid-November to mid-December. The policy statement indicated purchases of \$60/\$30 in the December cycle (i.e. mid-December to mid-January). The Committee expects that purchases will continue to be reduced by \$15 billion per month after the December-January cycle, but the statement also indicated that officials will alter the plan if economic conditions warrant.

We found the characterization of inflation in the policy statement, and in Chair Powell's discussion in the press briefing, to be interesting and revealing. The new information suggested that Fed officials are not deeply concerned about inflation and that they are focused on promoting full employment. The relevant passage from the policy statement is as follows:

Inflation is elevated, largely reflecting factors that are expected to be transitory. Supply and demand imbalances related to the pandemic and the reopening of the economy have contributed to sizable price increases in some sectors.

The first sentence suggests that Fed officials have become less confident in the view that inflation is transitory. By noting that inflation is "expected" to be transitory implies that some policymakers have doubts. This hedging contrasts with the definitive view in the September statement: "Inflation is elevated, largely reflecting transitory factors."

The second sentence from the new statement, read in isolation, does not lend itself to easy interpretation, but Chair Powell provided clarity in his press briefing. He noted that there are different definitions of transitory. One definition might be focused on time, where transitory is viewed as a brief period. The Fed's definition, however, does not have a time dimension. Powell (and presumably other Fed officials) view transitory as meaning that there are no lasting effects; conditions eventually will return to their previous state. The second sentence, Chair Powell noted, was added to the policy statement to clarify this definition of transitory. The supply and demand imbalances now driving prices higher will eventually work themselves out, Fed officials believe, which will push inflation back to its pre-pandemic path. The adjustment might take time, but time is not a feature of the Fed's definition of transitory.

Other comments of Chair Powell during the press conference suggested that he saw recent price pressure as purely the result of pandemic-related supply disruptions. He recognized that the economy was strong, but he highlighted supply problems as the inflation driver, and he viewed these disruptions as being resolved over time. He did not seem to recognize that highly accommodative monetary policy and the strong dose of fiscal policy administered over the past year-and-one-half were having a meaningful influence on inflation.

Reporters at the press briefing asked in different ways about the prospects for raising interest rates to counter inflation, but Chair Powell indicated that this is not the time to raise interest rates. Employment is still far from its maximum level, and supply-side problems driving inflation will work themselves out. Chair Powell was asked about balancing employment and inflation goals or weighing tradeoffs between employment and inflation, but he saw no need for balancing: employment is still below its maximum level and inflation is transitory (by the Fed's definition).

In short, we have a highly dovish Fed, or at least a highly dovish Fed Chair.