U.S. FOMC Review

- FOMC: rate hikes (plural) on the horizon

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Monetary Policy

As widely expected, the Federal Open Market Committee decided to quicken the pace of tapering its quantitative easing program. Beginning with the mid-January to mid-February cycle, the Fed will double the monthly reduction in purchases to $20 billion for Treasuries and $10 billion for mortgage-backed securities. This faster effort will end the program in mid-March (table, next page).

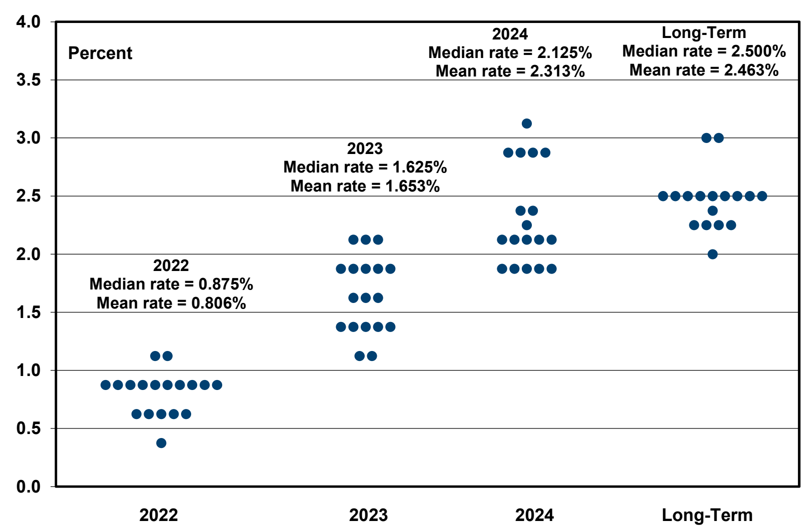
The completion of QE opens a door to interest rate hikes, and the Committee sees an obvious need to act on this front, as the median observation in the new dot plot suggests three interest rate hikes net year. Officials see more tightening in 2023 and 2024 (chart, below).

The Committee plans to begin the interest rate increases when the economy reaches maximum employment, and reporters at the press briefing probed for insights into what constitutes maximum employment. Chair Powell, as usual, was evasive, noting that the determination will be a judgement call by the Committee and will depend on an array of labor-market indicators. However, he also noted that he viewed the economy as making rapid progress toward the employment objective. He also noted that the current cycle is different than the previous one, as it involves stronger demand and more rapid improvement in the labor market. Accordingly, Mr. Powell left no doubt that the time span between the end of QE and the first interest rate hike would be shorter than the lag of almost 14 months in the experience associated with the financial crisis (tapering ended in October 2014 and the first interest rate hike occurred in December 2015).

Reporters in the Q&A session raised the issue of balance sheet reduction (i.e. the redemption of securities or quantitative tightening). Chair Powell noted that officials addressed this issue for the first time, merely reviewing the experience in the previous cycle. He again noted that the current episode is vastly different than the previous one, and thus he would not look to the past for guidance in this case.

Chair Powell was asked about the factors that led to the hawkish pivot by the FOMC. In general, officials saw inflation as becoming more broadly based and more persistent than previously believed. Specifically, he noted that his view began to

FOMC Rate View: Year-End 2022, 2023, 2024 & Long-Term*



** Each dot represents the expected federal funds rate of a Fed official at the ends of 2022, 2023, 2024, and long-term. Normally, this graph would contain 19 projections (seven governors of the Federal Reserve Board and 12 reserve bank presidents), but one governorship was open at the December 2021 meeting. Moreover, only 17 Committee members provided forecasts for the long-term projection.*

Source: Federal Open Market Committee, Summary of Economic Projections, December 2021 shift shortly after the November FOMC meeting. A strong reading on the employment cost index, followed by a robust employment report and a hefty increase in the CPI led him to conclude that more decisive actions is needed.

While Fed officials now see inflation as more of a problem, they still seem to have an optimistic slant. The Summary of Economic Projections shows a median core inflation rate next year of 2.7 percent (table). Our current projection shows a rate of 3.4 percent on the Fed's preferred gauge (the core price index for personal consumption expenditures).

Quantitative Easing Taper Schedule

	Initial Nov 3 FOMC meeting		Revised Dec 15 FOMC meeting	
	Treasury	MBS	Treasury	MBS
Oct-Nov	80	40	80	40
Nov-Dec	70	35	70	35
Dec-Jan	60	30	60	30
Jan-Feb	50	25	40	20
Feb-Mar	40	20	20	10
Mar-Apr	30	15	0	0
Apr-May	20	10		
May-Jun	10	5		
Jun-Jul	0	0		

Sources: Federal Open Market Committee; Daiwa Capital Markets America

Economic Projections of the FOMC, December 2021*

	2021	2022	2023	2024	Longer Run
Change in Real GDP	5.5	4.0	2.2	2.0	1.8
September projection	5.9	3.8	2.5	2.0	1.8
Unemployment Rate	4.3	3.5	3.5	3.5	4.0
September projection	4.8	3.8	3.5	3.5	4.0
PCE Inflation	5.3	2.6	2.3	2.1	2.0
September projection	4.2	2.2	2.2	2.1	2.0
Core PCE Inflation	4.4	2.7	2.3	2.1	--
September projection	3.7	2.3	2.2	2.1	--
Federal Funds Rate	0.1	0.9	1.6	2.1	2.5
September projection	0.1	0.3	1.0	1.8	2.5

** Median projections*
Source: Federal Open Market Committee, Summary of Economic Projections, December 2021