US Daily: September FOMC Recap: A Faster Taper (Mericle)

- The FOMC provided advance notice that tapering "may soon be warranted" at its September meeting today, as widely expected, and will likely announce the start of tapering at its November meeting. Powell revealed in the press conference that FOMC participants favor concluding the taper around mid-2022, which likely implies a tapering pace of $15bn per month.
- The median dots showed 0.5 hikes in 2022, 3 more hikes in 2023, and 3 more hikes in 2024, more hawkish than our expectation of 0, 2, and 3. But we see the overall message as a bit less hawkish, both because the split vote on a 2022 hike came alongside a high median core inflation forecast of 2.3% in 2022, and because our best guess is that Chair Powell's own projections show 0 hikes in 2022, 2 in 2023, and 2 in 2024, a more dovish path than implied by the median.
- The dot plot now shows a wide range of participant forecasts by 2024, with seven participants showing no more than four hikes cumulatively by that horizon, while many others expect four hikes per year at that point. This suggests to us that there is still a range of opinion on the FOMC about what pace of tightening the new monetary policy framework would call for if inflation eventually calms down to 2% or only modestly higher, as most participants expect.

Jan Hatzius
+1(212)902-0394 | jan.hatzius@gs.com
Goldman Sachs & Co. LLC

Alec Phillips
+1(202)637-3746 | alec.phillips@gs.com
Goldman Sachs & Co. LLC

David Mericle
+1(212)357-2619 |
david.mericle@gs.com
Goldman Sachs & Co. LLC

Spencer Hill, CFA
+1(212)357-7621 | spencer.hill@gs.com
Goldman Sachs & Co. LLC

Joseph Briggs
+1(212)902-2163 |
joseph.briggs@gs.com
Goldman Sachs & Co. LLC

Ronnie Walker
+1(917)343-4543 |
ronnie.walker@gs.com
Goldman Sachs & Co. LLC

September FOMC Recap: A Faster Taper

The FOMC provided advance notice that tapering "may soon be warranted" at its September meeting today, as widely expected. Chair Powell said that in his view the remaining test for tapering of "substantial further progress" in the labor market is "all but met," and that he didn't need to see a "very strong" September employment report, but would like to see a "decent" one. This suggests that the FOMC will likely announce the start of tapering at its November meeting.

Powell also revealed that FOMC participants favor concluding the taper around the middle of 2022, which we take to imply a tapering pace of $15bn per month. A number of FOMC participants had recently advocated a faster pace of tapering, and we had seen $15bn per month vs. $15bn per meeting as a close call before today. If the FOMC finishes the taper by the middle of next year, rate hikes could come under active discussion as early as September 2022, though we do not expect liftoff until 2023.

The median dots showed 0.5 hikes in 2022, 3 more hikes in 2023, and 3 more hikes in 2024, more hawkish than our expectation of 0 in 2022, 2 in 2023, and 3 in 2024. But we see the overall message from today's meeting as a bit less hawkish than the median dots suggest, for a few reasons.

First, the split vote in 2022—9 participants forecasted at least one hike, versus our expectation that 8 would—came alongside a median core PCE inflation forecast of 2.3% and a median unemployment rate forecast of 3.8% (in fact, no one projected a 2022 unemployment rate above the FOMC's median 4.0% estimate of full employment). This suggests that some participants have a somewhat higher inflation threshold for liftoff, a greater willingness to look through inflation caused by a supply shock, or an aggressive target for full employment that would deter a hike even if inflation exceeds 2%. In addition, our own core PCE forecast for 2022Q4 is lower than the FOMC's at 2.0%, likely because we have penciled in more payback next year for stretched durable goods prices, and this too could deter a hike.

Second, Powell stuck strongly to the message that high inflation will ultimately be transitory and that inflation expectations remain well anchored. He attributed the move up in the FOMC's core inflation forecasts to longer-lasting but still ultimately transitory effects of supply chain disruptions. He also continued to emphasize that long-run inflation expectations—captured by the Fed's index of common inflation expectations—are well anchored and have only reversed last cycle's damaging decline, and he downplayed measures of short-term inflation expectations, including the New York Fed's three-year-ahead measure.

Third, our best guess is that Chair Powell's own projections show 0 hikes in 2022, 2 in 2023, and 2 in 2024, a more dovish path than implied by the median. While it is very hard to know, we would be surprised if seven participants had more dovish projections than he does.

Admittedly, it is possible that some Fed officials did not pencil in a 2022 hike today for strategic reasons, namely to avoid the impression that tapering and rate hikes are tightly linked. If so, these participants might feel more at liberty to show a hike after the tapering news has been delivered, if appropriate.

The dot plot now shows a wide spread of participant forecasts by 2024. Seven participants expect no more than four hikes cumulatively by 2024, while about seven others seem to expect four hikes per year at that point. This likely reflects different views about what pace of tightening the new monetary policy framework would call for in an environment where inflation calms down to 2% or only modestly higher.

Many FOMC participants seem to take the view that the average inflation targeting mission has been accomplished for this cycle, and that hiking at a regular quarterly pace back toward neutral would be appropriate. But another large group that we suspect includes Powell seems to instead envision a slower pace of tightening, perhaps reflecting the thought that if inflation is only a touch above 2%, the FOMC should tighten more gradually in pursuit of the new "broad-based and inclusive" interpretation of its maximum employment goal introduced by the new framework.

Powell also noted today that Fed officials will issue a discussion paper soon about a possible central bank digital currency.

David Mericle

Disclosure Appendix

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