

US Daily: A Faster Taper and a Slightly Earlier Liftoff (Mericle/Hatzius/Walker)

- Several FOMC participants have signaled over the last couple of weeks that they are open to accelerating the pace of tapering, including Vice Chair Clarida and most recently San Francisco Fed President Daly. The increased openness to accelerating the taper pace likely reflects both somewhat higher-than-expected inflation over the last two months and greater comfort among Fed officials that a faster pace would not shock financial markets.
- We now expect the Fed to announce at its December meeting that it is doubling the pace of tapering to \$30bn per month starting in January. In that scenario, the FOMC would announce the final two tapers at its January meeting and implement the final taper in mid-March, several days before the March FOMC meeting.
- While this faster pace of tapering would allow the FOMC to consider a rate hike as early as March, our best guess is that it will wait until June, when a few additional employment reports will be available. We now expect hikes in June, September, and December, for a total of three in 2022 (vs. two in July and November previously), followed by two hikes per year starting in 2023. We see an alternative path of hikes at the May, July, and November meetings as a realistic possibility too. The largest risk to our expectation of an early liftoff is that some participants might find it hard to square a still-large employment gap relative to the pre-pandemic level with the guidance that the FOMC will not hike until the labor market reaches maximum employment.

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A Faster Taper and a Slightly Earlier Liftoff

Over the last couple of weeks, several FOMC participants have indicated that they prefer a faster pace of tapering or are at least open to discussing it at the December meeting. Last week, Vice Chair Clarida said that it “may well be appropriate at [the December FOMC] meeting to have a discussion about increasing the pace at which we’re reducing our balance sheet,” the first such signal from the leadership. And yesterday, San Francisco Fed President Mary Daly—who has leaned dovish in the past—said that if labor market conditions continue to improve and inflation remains strong, she “would completely support an accelerated pace of tapering.” Other participants including Atlanta Fed President Bostic, St. Louis Fed President Bullard, and Governor Waller have also argued for accelerating the pace of tapering.

The increased openness to accelerating the taper pace likely reflects both somewhat higher-than-expected inflation over the last two months and greater comfort among Fed officials that a faster pace would not shock financial markets. Some Fed officials might be persuaded to accelerate the taper by the upside inflation surprises over the last two months, especially on the shelter component. Other Fed officials, especially in the leadership, might have already expected inflation prints to remain high through the winter, but—with market pricing of rate hikes in the first half of 2022 rising—might now feel more confident that accelerating the pace, which is already more than twice as fast as the pace last cycle, will not produce the sort of unexpected market turmoil that reductions in balance sheet accommodation have sometimes caused in the past.

Exhibit 1: Several FOMC Participants Have Suggested Accelerating the Taper Timeline

Recent Fed Commentary on Tapering		
Participant	Date	Quote(s)
Daly	24-Nov	"If [the labor market continues to improve and inflation remains strong] ... then those are the things that would say, looks like we need faster tapering."
Bostic	22-Nov	"A faster taper would certainly give us more optionality as we move into 2022 and see sort of where the data takes us ... That timing [finishing the taper in the first quarter] I would be comfortable with given the way the data has come in recently."
Clarida	19-Nov	"I'll be looking closely at the data that we get between now and the December meeting, and it may well be appropriate at that meeting to have a discussion about increasing the pace at which we're reducing our balance sheet."
Waller	19-Nov	"If you double the pace of tapering in January, you could be done by the beginning of April and that brings you...policy space... should you need it. I'm not saying we have to but if you get the taper done, you could have a rate hike as early as the second quarter."
Bullard	15-Nov	1. "I think it behooves the committee to go in a more hawkish direction in the next couple of meetings so we are managing the risk of inflation appropriately." 2. "We could move faster – we kept optionality on this that we could speed up the taper if it is appropriate."

Source: Bloomberg, Goldman Sachs Global Investment Research

We now expect the Fed to announce at its December meeting that it is doubling the pace of tapering to \$30bn per month starting in January. In that scenario, the FOMC would announce the final two tapers at its January meeting and implement the final taper in mid-March, several days before the March FOMC meeting. This timeline would be consistent with comments from Waller, Bullard, and Bostic advocating ending the taper by the first quarter of 2022.

While this faster pace of tapering would allow the FOMC to consider a rate hike as early as its March 15-16 meeting, our best guess is that it will wait until the June meeting. By that point, a few additional employment reports will be available and will hopefully show a labor market that Fed officials feel more comfortable characterizing as having reached maximum employment (Exhibit 2). The FOMC might say at its March meeting that it is evaluating the impact of tapering and will begin the discussion of rate hikes soon, then hint at its May meeting that a hike is coming soon, before ultimately hiking in June.

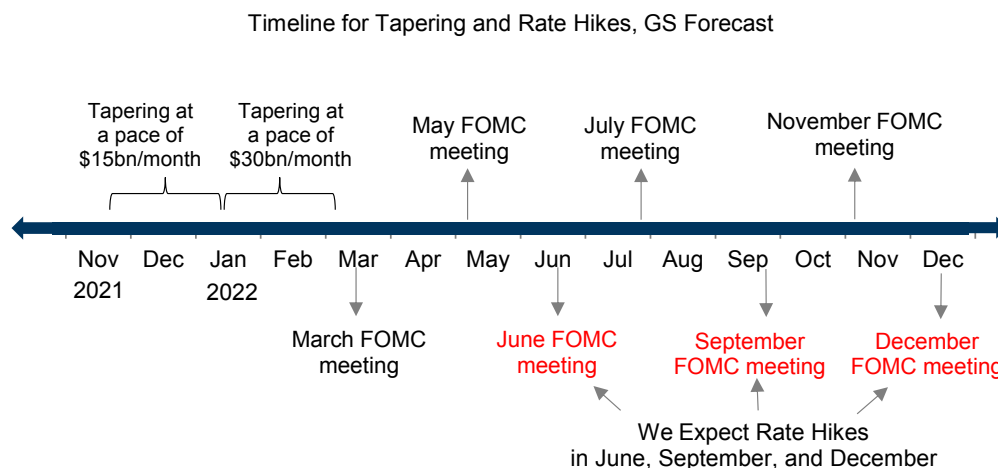
Exhibit 2: We Now Expect the FOMC to Deliver the First Hike at Its June Meeting

Latest Data Available at FOMC Meetings, GS Forecast					
Indicator	Units	March 15-16 Meeting	May 3-4 Meeting	June 14-15 Meeting	2019 Average
Real activity					
GDP growth (GS tracking estimate)	% , QoQ AR	4.5	4.0	4.0	2.6
<i>Period data describes</i>		2022Q1	2022Q2	2022Q2	-
Unemployment rate (U3)	%	4.0	3.9	3.7	3.7
		Feb-22	Mar-22	May-22	-
Unemployment rate (U6)	%	7.3	7.2	7.0	7.2
		Feb-22	Mar-22	May-22	-
Employment-population ratio	%	59.4	59.5	59.6	60.8
		Feb-22	Mar-22	May-22	-
Labor force participation rate	%	61.9	61.9	62.0	63.1
		Feb-22	Mar-22	May-22	-
Employment level vs. pre-pandemic	Millions	-2.7	-2.4	-1.8	-
		Feb-22	Mar-22	May-22	-
Prices					
Core PCE	% , YoY	4.4	4.3	3.8	1.7
		Jan-22	Mar-22	Apr-22	-
Core CPI	% , YoY	5.9	6.0	5.0	2.2
		Feb-22	Mar-22	May-22	-

Source: Department of Commerce, Department of Labor, Goldman Sachs Global Investment Research

We expect the FOMC to follow a June hike with hikes in September and December for a total of three in 2022 (Exhibit 3), vs. our previous forecast of two hikes in July and November. While we expect inflation to gradually decline next year, at the time of the December meeting the latest available inflation prints would still be 2.6% year-on-year for core PCE and 3.6% for core CPI under our forecast. We continue to expect a pace of two hikes per year starting in 2023 and we have not made any change to our terminal rate forecast of 2.5-2.75%, so we are effectively pulling one future hike forward into 2022.

We see an alternative path of hikes in May, July, and November next year as a realistic possibility too.

Exhibit 3: We Now Expect Hikes in Three Hikes in 2022 vs. Our Previous Forecast of Two

Source: Goldman Sachs Global Investment Research

The largest risk to our expectation of an early liftoff is that some participants might find it hard to square a still-large employment gap relative to the pre-pandemic level—1.8mn at the time of the June meeting—with the guidance in the FOMC statement that the committee will not raise interest rates until the labor market reaches maximum employment. But we expect the unemployment rate to have fallen to 3.7% by June 2022, and we think that most participants, even many of the doves, will conclude that after a prolonged period in which job opportunities have been plentiful, any decline in the participation rate that remains by the middle of next year is likely to be mostly voluntary or structural.

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Disclosure Appendix

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