First Trust
ECONOMIC RESEARCH REPORT
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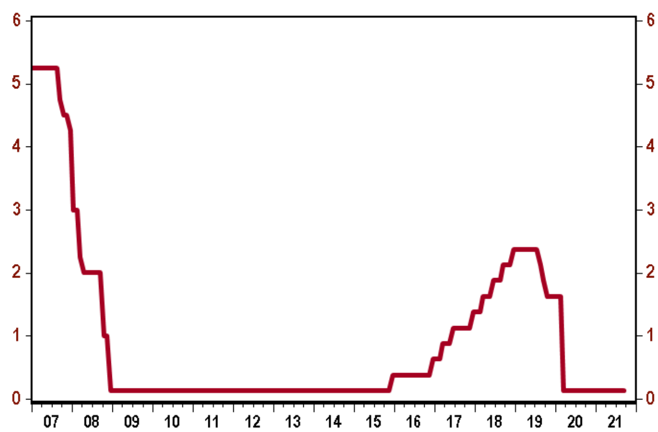
September 22nd, 2021 • 630.517.7756 • www.ftportfolios.com

Fed Set to Announce Taper in November

No changes to monetary policy today, but plenty of changes to the outlook for monetary policy in the next few years.

Based on language the Federal Reserve added to its statement as well as comments by Fed Chief Jerome Powell at the post-meeting press conference, the Fed is very likely to announce a "tapering" of quantitative easing at the next meeting in early November. The only thing that could stop this is if the economy takes an unexpected turn for the worse. Always possible, not likely.



The key sentence added to the statement was that "[i]f progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted." Then, at the press conference, Powell *twice* said that the hurdle of "substantial further progress" toward the Fed's goals before taping begins has been "all but met." He also noted that the Fed was only looking for a "decent" employment report between now and then, nothing spectacular.

In addition, Powell made it clear at the press conference that tapering is likely to end by mid-2022 and we shouldn't expect any rate hikes until tapering is done.

In terms of rate hikes, there were some significant changes to the "dot plots," which anonymously set out Fed policymakers' projections for short-term interest rates over the next few years. Like in June, no one expects a rate hike this year. However, for 2022, the Fed is now evenly split, with nine policymakers projecting zero rate hikes while nine forecast at least one hike.

It's important to recognize, however, that the composition of the Fed is likely to change by early next year even if Fed Chief Jerome Powell is re-appointed. For example, Fed Vice Chair Richard Clarida, who was appointed by President Trump, is very likely to be replaced. The same goes for Fed Regulatory Chief Randy Quarles. In theory, Quarles could remain a regular Fed governor even after his term as regulatory chief finishes in October, but that's unlikely. So that would give President Biden a chance to appoint at least two more dovish new members to the Fed, tilting those dots back toward zero rate hikes in 2022.

Meanwhile, with tapering likely to continue until mid-2022, that would leave only four months or so before the mid-term election. We don't think the Fed will raise rates during that period.

The dot plots also got more aggressive about 2023, with the median short-term target at 1.0% for the end of 2023 (versus a prior estimate of 0.625%). For 2024, the median policymaker anticipates ending the year with a short-term target of 1.75%.

Oddly, the more aggressive projections for the path of short-term rates were not accompanied by more aggressive economic forecast. The most significant change to the economic forecast was a downgrade for real GDP growth this year (5.9% versus a prior estimate of 7.0%) with slightly faster growth in 2022-23. Meanwhile, the Fed raised the inflation forecast for this year (4.2% versus a prior estimate of 3.4%), but with almost no change to inflation forecasts for 2022-23.

The bottom line is that barring some unexpected turn of events, the Fed is very likely to announce a tapering to QE in early November and start implementing that tapering soon thereafter. For rate hikes, we're thinking very late 2022 (after the mid-term elections) at the earliest. The problem with all this is that there is no reason QE should still be in effect; tapering should have started, and ended, a long time ago. In addition, the Fed's forecast on inflation is clearly too low. And with the Fed not raising interest rates anytime soon, inflation is likely to turn out much more persistent than the Fed hopes.

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Text of the Federal Reserve's Statement:

The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, *thereby promoting its maximum employment and price stability goals.*

With progress on vaccinations and strong policy support, indicators of economic activity and employment have continued to strengthen. The sectors most adversely affected by the pandemic have improved in recent months, but the rise in COVID-19 cases has slowed their recovery. Inflation is elevated, largely reflecting transitory factors. Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.

The path of the economy continues to depend on the course of the virus. Progress on vaccinations will likely continue to reduce the effects of the public health crisis on the economy, but risks to the economic outlook remain.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. With inflation having run persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent and expects it will be appropriate to maintain this target range until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. Last December, the Committee indicated that it would continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month until substantial further progress has been made toward its maximum employment and price stability goals. Since then, the economy has made progress toward these goals. If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted. These asset purchases help foster smooth market functioning and accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Raphael W. Bostic; Michelle W. Bowman; Lael Brainard; Richard H. Clarida; Mary C. Daly; Charles L. Evans; Randal K. Quarles; and Christopher J. Waller.