Powell: “Our tools cannot ease supply constraints.”

November 3, 2021

FOMC Recap

Tapering

The Fed formally announced tapering at a pace of $15B/month, which would bring QE to an end in June 2022. The pace “will likely be appropriate each month,” although the Fed will adjust “if warranted by changes in the economic outlook.”

Why is the pace of tapering faster than tapering last time around? “The economy is in quite a different place than back in 2013. This is an economy where demand is very, very strong. The need for further stimulus is far less.”

After tapering, will the Fed take steps to reduce its balance sheet? “We haven’t gone back to those questions yet but now that we have started tapering we will start having those discussions.”

Takeaway – ho hum, no Taper Tantrum this time!

Rate Hikes

"Our tools cannot ease supply constraints." The Fed doesn't believe hiking resolves the current pricing issues. That's critical to keep in mind as we consider whether the Fed will hike.

"I don't think we're behind the curve." Keep in mind, he can't say the Fed *won't* hike next year because it would spur inflation expectations. Even though he may believe there are no hikes likely next year, he needs to leave that threat out there to prevent expectations from running even hotter.

He stressed there will be different and more stringent tests before raising Fed Funds. "We have not focused on the liftoff test because we are not at maximum employment yet."

"It would be premature to hike interest rates today."

"We don't think it's a good time to increase interest rates because the labor market still needs to heal a bit."

"We will be patient, but we won't hesitate."

Takeaway – the Fed isn't hiking anytime soon, but stands at the ready to change that if needed. I still disagree with the market and believe the first hike is 2023 at the earliest.

Inflation

The Fed expects inflation to subside in Q2 or Q3 of next year. Don't skip that! If inflation fails to subside by Q3, will the Fed throw in the towel and start hiking?

The Fed will not hesitate to act if its view on inflation being transitory changes. Furthermore, they define transitory as "it will not leave behind permanently higher inflation."

"This is not a classic Phillips curve situation. Inflation is not due to a tight labor market, it's due to labor shortages and bottlenecks."

Takeaway – the Fed acknowledges inflation is running higher than expected, for longer than expected. But hiking rates won't help and would more likely damage the recovery.

Labor Market

Powell really drove this point home…full employment will dictate rate hikes.

Maximum employment will incorporate a broad range of things. The unemployment rate may be low, but there are some big groups still on the sidelines.

"By many measures, we have a tight labor market. The issue is how persistent is that? There is a large number of people that are staying out of the market."

Takeaway – because the inflation test has already been met, the labor market will dictate rate hikes. But Powell is giving himself some wiggle room by saying it will be a much more broad-based measure than just the headline UR. Don't expect a hike just because the UR goes below 4.0%.

Climate Change

Nah

Re-Nomination

"I won't answer your question and I won't have any comment on the re-nomination process at all." I think I detected a snarl.

Takeaway – Does Biden dare roil markets in the face of falling approval ratings and some progressive wing-clipping yesterday? Or does he go all-in to appease the further left?

Market Reaction

Odds of a July 2022 rate hike dropped from 97% to 92%, but the market still expects two hikes next year.

2T up 2bps to 0.47%

10T up 3bps to 1.59%

Stocks mildly higher

Fortunately, we get the next labor market report on Friday. These labor reports will continue to take on increased significance if we are to believe reaching full employment is the litmus test for rate hikes.