

Powell's Taper Whisper, Dovish Rate Guidance Drive Equities Higher

- Treasuries and equities rallied, dollar dipped...
- ...as Powell's policy guidance confirmed FOMC minutes...
- ...which pushed back on the hawks
- 2022 will attach more voting weight to the hawks
- We still expect a taper announcement in December...
- ...first hike in 2023Q1 with risk of earlier

Federal Reserve Chair Powell engineered a soft taper form of guidance that markets interpreted dovishly. I would encourage you to read his short speech as I'll only provide market-impactful highlights ([here](#)). Following his remarks, the S&P500 rallied, the USD dipped and the US Treasury curve rallied in nearly equal fashion in 2s & 10s.

That said, nothing Powell said departed from the guidance we already had from the minutes to the July FOMC meeting which was my expectation going into his speech. The top of the house is still holding at bay the hawkish contingent. A part of market opinion that is short Treasuries into these events out of fear that the Chair and the broader committee will suddenly pivot toward the hawkish (mostly nonvoting at present) regional Presidents got stuck scrambling to cover for the second time in less than ten days. At some point they may well get paid for being short and that could be around the corner into 2022, but just not yet.

NOTHING IMMINENT

Before reviewing what Powell said, it's important to note what he did not say. If the Chair was leaning toward reducing bond purchases as soon as the September 22nd meeting when another round of forecasts and dots are due, then he would have tightened up his language that connotes a sense of timing. **One way he might have done that would be to have said the committee was leaning toward reducing purchases 'soon' or 'very soon'** which they've employed in the past in order to signal imminent shifts at the next meeting.

YES TO PRICE STABILITY, NOT YET THERE ON JOBS

Key is the following quote which just indicates tapering \$120B of Treasury and MBS purchases 'this year' and stops short of an ironclad commitment by saying 'it could be appropriate' (with emphasis added to the passage).

"My view is that the **"substantial further progress" test has been met for inflation. There has also been clear progress toward maximum employment.** At the FOMC's recent July meeting, I was of the view, as were most participants, that if the economy evolved broadly as anticipated, **it could be appropriate to start reducing the pace of asset purchases this year.** The intervening month has brought more progress in the form of a strong employment report for July, but also the

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further spread of the Delta variant. We will be carefully assessing incoming data and the evolving risks. Even after our asset purchases end, our elevated holdings of longer-term securities will continue to support accommodative financial conditions."

Still, it's notable that Powell is sounding less and less strident that the inflation mandate is not being durably achieved almost each time he speaks compared to earlier in the year when he full-on dismissed the jump in inflation as just a year-ago base effect. In fairness to our work on inflation, this is in keeping with our expectations.

What Powell is leaning on is emphasis upon still being short on the full employment part of the mandate by stopping short of saying something like "in my view the substantial further progress test has also been met for jobs." To the Fed Chair, that point probably still lies some time away depending upon the course of nonfarm payrolls starting with next Friday's update for August. Still, the speech was almost remarkably light on the kind of inclusion references that Powell has previously emphasized.

UNCHANGED FORWARD RATE GUIDANCE

Further, what the Chair said on timing rate hikes off taper decision is also no different from the July minutes:

"The timing and pace of the coming reduction in asset purchases will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a different and substantially more stringent test. We have said that we will continue to hold the target range for the federal funds rate at its current level until the economy reaches conditions consistent with maximum employment, and inflation has reached 2 percent and is on track to moderately exceed 2 percent for some time. We have much ground to cover to reach maximum employment, and time will tell whether we have reached 2 percent inflation on a sustainable basis."

Compare that to what the minutes to the July meeting said:

"Many participants noted that, when a reduction in the pace of asset purchases became appropriate, it would be important that the Committee clearly reaffirm the absence of any mechanical link between the timing of tapering and that of an eventual increase in the target range for the federal funds rate."

"Several participants emphasized that an announcement of a reduction in the Committee's pace of asset purchases should not be interpreted as the beginning of a predetermined course for raising the federal funds rate from its current level."

Nevertheless, it's a bit of a credibility issue when the FOMC tries to downplay extrapolating the rate hike path off of tapering decisions when the FOMC's own dot plot shows a fair contingent indicating hikes starting next year and a majority guiding hikes in 2023.

OUR UNCHANGED EXPECTATIONS

Our house view remains that a taper announcement is likely at the December meeting with implementation in January.

The December meeting affords the opportunity of announcing the first taper decision in the context of a full set of communications including fresh forecasts, a fresh dot plot and a full press conference.

Regarding nearer term risk, this paragraph makes it clear that he's in no rush and wants to observe further developments. So again, we are getting nothing different on taper timing than what the July minutes indicated.

"Incoming data should provide more evidence that some of the supply-demand imbalances are improving, and more evidence of a continued moderation in inflation, particularly in goods and services prices that have been most affected by the pandemic. We also expect to see continued strong job creation. And we will be learning more about the Delta variant's effects. For now, I believe that policy is well positioned; as always, we are prepared to adjust policy as appropriate to achieve our goals."

MORE SPARKS COULD FLY IN 2022

All that said, the stage is set for more voting heft to back the more hawkish voices on the FOMC into 2022. The Presidents from Boston, St. Louis, KC and Cleve all rotate into the voting members and only one voting 2021 hawk will be lost from the rotation next year (Bostic). So on net, there will be three additional hawkish FOMC members with voting status next year. That doesn't mean they'll dominate, but at a minimum it raises the risk of quite a number of dissenting votes if the Chair sounds as dovish on timing and steps as he did today.

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