16 December 2021

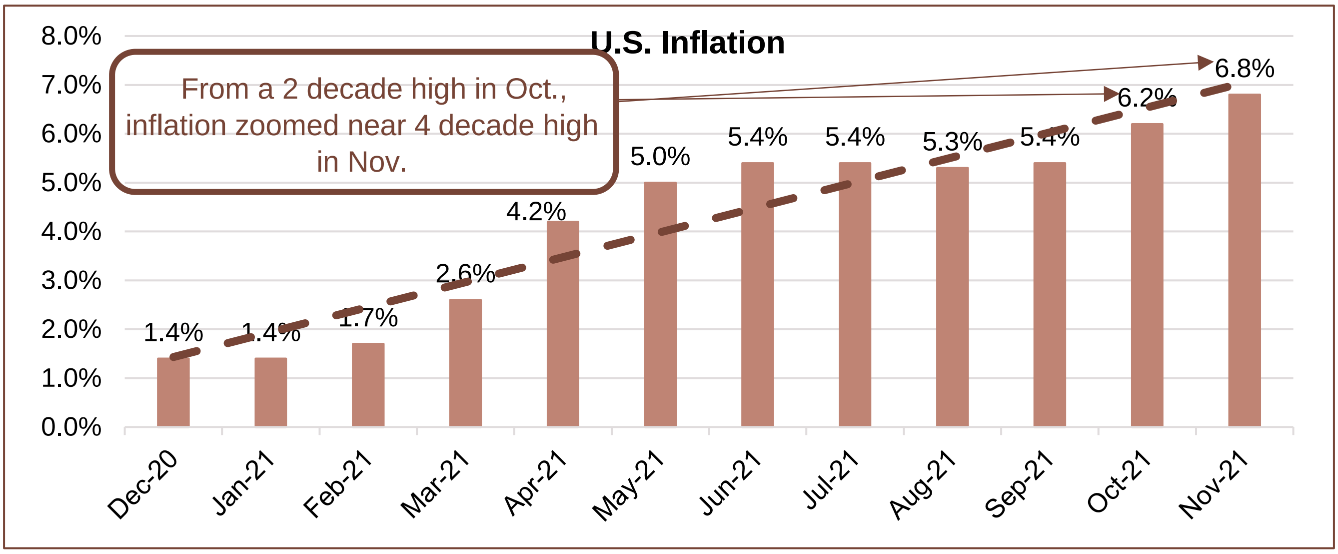
Fed shifts to inflation battle, tapering down pandemic support

Key Highlights

- Indicating at one of the **most hawkish policy supports in years**, the U.S. central bank said it will **double the pace at which it's scaling back purchases of treasuries** and mortgage-backed securities.
- Policy makers see **another three increases as appropriate in 2023 and two more in 2024**, bringing the funds **rate to 2.1%** by the end of that year.
- **The word "transitory" for inflation has now been "retired"**, with Fed now expecting inflation at 5.3% in 2021 and 2.6% in 2022.

Key Highlights

- Indicating at one of the **most hawkish policy supports in years**, the U.S. central bank said it will **double the pace at which it's scaling back purchases of treasuries** and mortgage-backed securities to $30 billion a month (USD 20 bn in treasuries and USD 10 bn in agency mortgage backed securities), putting it on track to conclude the program in early 2022, rather than mid-year as initially planned.
- The **new rate projections marks a major shift** from the last time forecasts were updated in September, when officials were evenly split on the need for any rate increases at all in 2022. The Fed's policymaking committee left its **benchmark rate near zero** but now projects **three rate hikes next year**, up from one in its September forecast, according to officials' median estimate. The panel foresees **three more increases in 2023 and two in 2024.** That would push the rate to **2.1% by the end of 2024**.
- **The word "transitory" for inflation has now been "retired"**, with Fed now expecting inflation at 5.3% in 2021 and 2.6% in 2022, 90 bps and 40 bps respectively higher than September projections.
- **Unemployment dropped to 4.2% in November from 4.6% in October**, a quicker pace of recovery than forecasters had anticipated.



Source: tradingeconomics.com

- **Consumer prices rose 6.8% in the year through November, marking the fastest pace of increase since 1982**. In recent months, surging food and energy prices and accelerating rental inflation have contributed more to overall inflation more than earlier in the year, when massive price increases were concentrated largely in the used-car market and a reopening leisure & hospitality sector.

- With the economy healing, but price gains pinching consumers, the Fed is scaling back bond purchases and getting in position to raise interest rates.

To Summarize

The Fed's final meeting of the year completed its **decisive shift away from providing full-blast support to the economy and toward guarding against the risk of rapid and lasting inflation**. While the Fed spent much of the year laying out a patient path for weaning the economy off the Fed's pandemic support, they have become more worried that a burst in prices this year could linger, resulting in a more proactive stance.

To Conclude

Risk sentiment improved following the announcement as a faster taper and earlier path to monetary policy tightening was largely priced in ahead of the Fed meeting. All U.S. indices saw a big last hour rally post the FOMC.

Mirroring the U.S. counterpart Indian markets too opened positive in morning. Both the U.S. and Indian markets have been factoring a rate hike as **liquidity withdrawal is also being done by both Fed and RBI**. To take it a step ahead, Fed speaking on likely rate hikes for next year is been taken as a positive signal in the short run indicating a kind of **confirmation that growth and inflation are here to stay**.

Investors should **follow the desired asset allocation** to avoid unfavourable portfolio outcomes in case of any volatility that flows in the Indian markets due to tapering.

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