December FOMC Meeting: A Policy Pivot, But Is It Really A "Hawkish" Pivot?

- The FOMC left the Fed funds rate target range unchanged, leaving the mid-point of the target range at 0.125 percent
- The FOMC doubled the pace of tapering the Fed's monthly asset purchases; the updated dot plot implies three Fed funds rate hikes in 2022

As expected, the FOMC left the Fed funds rate target range unchanged at the conclusion of their two-day meeting. As was also expected, the Committee announced it would double the rate at which it is tapering the Fed's monthly asset purchases, so beginning in January asset purchases will be reduced by $30 billion a month. The uncertainty around the December FOMC meeting revolved around the Committee's updated economic and financial projections, including the dot plot. The updated dot plot implies three 25-basis point funds rate hikes by year-end 2022, more than many, us included, were expecting. Though no longer using the word "transitory" to characterize inflation, the Committee's updated projections nonetheless have inflation receding at a faster pace than that expected by many private sector forecasters. Many are referring to the Committee has having made a "hawkish" pivot at their December meeting, a characterization with which we do not agree. To be sure, the perception of "hawkish" may make "hawkish" a reality for some, but we'll note that the real Fed funds rate remains significantly negative, the Fed's balance sheet will top out at around $9 trillion with no sense of the timing of paring it down, and even with the rate hikes implied by the updated dot plot, the funds rate would still end 2024 below the median estimate of the "neutral" funds rate. If all of that constitutes "hawkish," that term no longer has any meaning in the context of monetary policy.

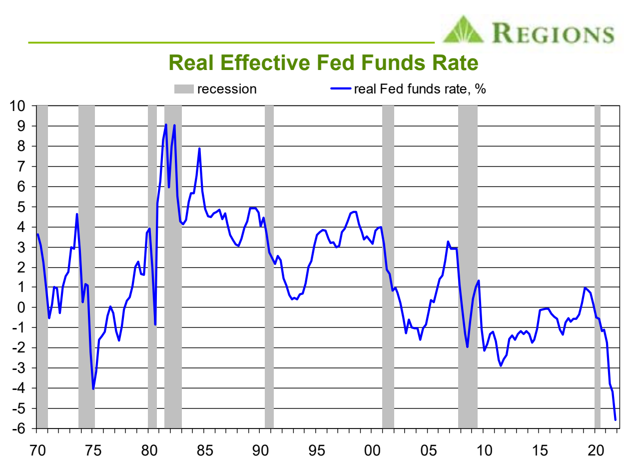
The Committee's assessment of current economic conditions gives a nod to "solid" job gains and the "substantial" decline in the unemployment rate over recent months. The biggest change in this part of the statement is the description of inflation. Gone is "inflation is elevated, largely reflecting factors that are expected to be transitory," having been replaced with "supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation." In his post-meeting remarks, Chairman Powell noted that prices pressures have broadened and have been more persistent than the Committee initially believed would be the case.

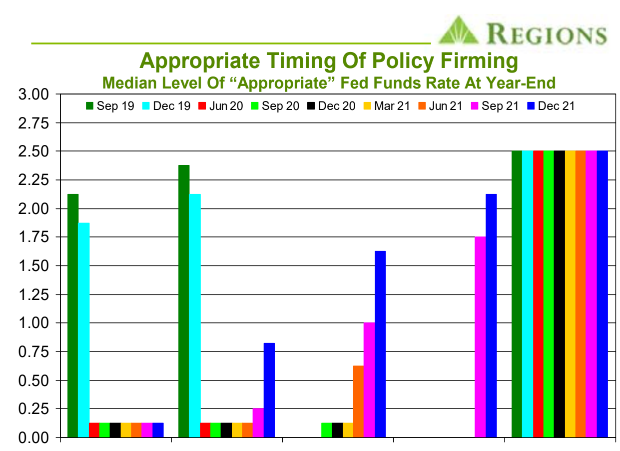
The updated projections show little change in expectations for real GDP growth over the forecast horizon. Reflecting the marked decline in the unemployment rate over recent months, however, the Committee now expects the jobless rate to average 3.6 percent in Q4 2022 and 3.4 percent in Q4 2023, down from 3.8 percent and 3.5 percent, respectively, in the September projections. On a Q4/Q4 basis, the Committee now expects PCE inflation of 5.4 percent in 2021 and 2.6 percent in 2022, compared to 4.2 percent and 2.3 percent, respectively, in the September projections. There are similar changes in the Committee's expectations of core PCE inflation. It is worth noting that 15 of the 18 members see the risks to their inflation forecast as being weighted to the upside, the highest number on record in the life of the projections.

The updated dot plot shows all 18 members feel at least one 25-basis point rate hike will be appropriate by year-end 2022, with the median dot implying three such rate hikes, up from what amounted to one-half of a hike in the September projections. The updated dot plot implies another three quarter-point hikes in 2023 and two more in 2024. It is worth noting that the year-end 2024 dot implies Fed funds rate target range mid-point of 2.125 percent, up from 1.75 percent in the September edition.

In his post-meeting press conference, Chairman Powell noted that this meeting marked the Committee's first discussion of potentially shrinking the Fed's balance sheet, and our sense is that this may come sooner in this cycle than was the case previously. Chairman Powell did note that he does not expect a "long delay" between ending the taper and starting to raise the funds rate, though he did point to the high degree of uncertainty around the course of the pandemic and its potential effects on the labor market and the broader economy. Chairman Powell did express disappointment over labor force participation not having rebounded as rapidly as had been expected, and noted that full employment is unlikely to look as it did in the pre-pandemic world, and however it may look, the Committee may begin raising the funds rate before it is achieved.

It is worth noting out that next year's dot plot(s) may look very different than this year's, given the soon to be changing composition of the FOMC. This simply goes to our earlier point that there is a difference between a less accommodative FOMC and a hawkish FOMC.





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