Special Commentary – The case for Fed tapering is clear, starting in November

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What happened

The Federal Reserve (Fed) is currently adding $120 billion per month to its balance sheet – $80 billion of U.S. Treasury securities and $40 billion agency mortgage-backed securities – through a process known as quantitative easing (QE). Investors are anxiously awaiting news of when the Fed will begin "tapering," or slowly reducing the size of its monthly bond purchases.

Our take – we expect tapering will begin in November

We now anticipate the Fed will announce, at its two-day meeting on September 21-22, that tapering will begin in November. Previously, we expected tapering to start in the first quarter of 2022 unless job growth was hitting roughly one million per month over the summer. Well, that is essentially what occurred in June and July, increasing by 938,000 and 943,000, respectively. Moreover, the unemployment rate has declined to 5.4% from a peak of 22.9% in April 2020.

Minutes from the last Fed meeting strongly suggested that tapering will begin sooner rather than later. Since then, seemingly all of the regional Fed presidents have publicly discussed the need to pare back the monthly purchases. The vast majority have either used a euphemism – such as "it's time to taper" or have explicitly said October or November. By our count, a plurality 6 of the 11 current voters are now effectively on the record for tapering in 2021.

We don't think that Fed Chairman Jay Powell will 'tip his hand' regarding tapering at the Fed's Jackson Hole Symposium this week. Frankly, it's not the right forum for it. More importantly, waiting until the September meeting will give the Fed the August jobs report, six more weeks of weekly jobless claims, along with another month of inflation data and COVID-19 delta variant numbers before unveiling its updated timeline. (We don't foresee a big economic impact due to delta, which is showing signs of peaking). Lastly, starting a few months earlier—later this year rather than in 2022—means that the tapering process can potentially go slower, if needed.

Will markets have another taper tantrum?

We don't foresee another taper tantrum resembling the shock created by then-Fed Chair Ben Bernanke's testimony before Congress in May 2013. While answering questions from lawmakers, Bernanke suggested the Fed may consider reducing its pace of bond purchases sooner than the market was anticipating. In response, bond yields spiked and U.S. equities declined.

The current economic environment is very different than in May 2013. As the next slide shows, nearly every economic metric is dramatically improved both since the 2020 COVID-recession and relative to 2013. Additionally, given the amount of chatter about QE from Fed officials for months, we believe that markets are prepared for tapering to start later this year or early next year. Thus, a few months earlier isn't a surprise.

Bottom line

The case for the Fed to begin tapering soon appears clear. We expect the Fed will announce at its September meeting that tapering will begin in November.

Current environment very different than during 2013's taper tantrum

Nearly every economic metric is dramatically improved both since the 2020 COVID-recession and relative to 2013.

Indicator	May 2013	August 2021
GDP growth (annualized)	2Q13: 0.6% ✗	2Q21: 6.5% ✓
Core inflation (year over year change)	1.7% ✗	4.3% ✓
New home sales (annualized)	428,000 ✗	708,000 ✓
Existing home sales (annualized)	4.55 million ✗	5.28 million ✓
Unemployment rate	7.5% ✗	5.4% ✓
10-year U.S. Treasury yield	2.1% ✗	1.3% ✓
Asset purchases per month	$85B ✗	$120B ✓

Data Sources: Truist IAG, Bloomberg, Bureau of Labor Statistics, Bureau of Economic Analysis; data through August 25, 2021.

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