GIAM Macro & Market Research- Market Commentary

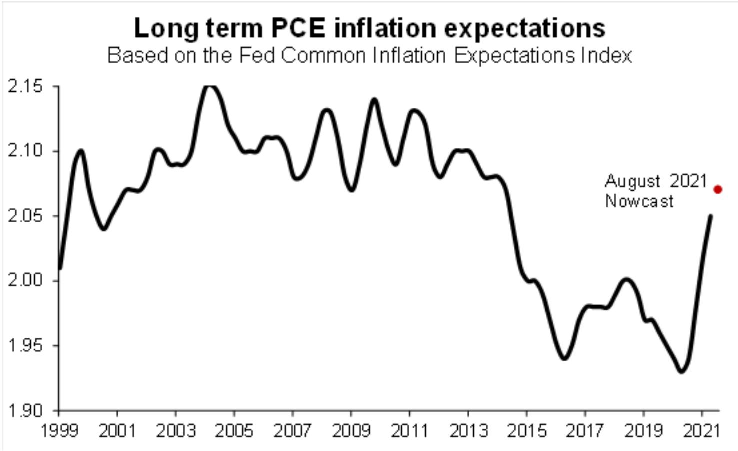
Powell warns about the beginning of tapering this year, Delta variant permitting.

- **Chair Powell's speech at Jackson Hole turned out more explicit than expected. If the Delta variant does not disrupt the evolution of the labour market, tapering should begin before the end of the year.**
- **Powell reframed the current Fed's narrative in a more optimistic way. The FOMC deems the progress on inflation (actual and expected) enough to slow down QE; healing of the labour market is under way.**
- **To minimise the risk of a taper tantrum, Powell stressed once more the fact that the decision to reduce asset purchases is not related to that of raising rates. Therefore, monetary policy will remain broadly accommodative even after tapering has started.**
- **If the Delta variant does not stand in the way of the current strong job creation in services, tapering should begin in November. We stick to our view of a first rate hike in mid-2023**.

Chair Powell's speech turned our more explicit than expected, as he drew strong implications from the rosy picture of the economy the Fed has advertised since the Spring. He claimed that substantial further progress has been reached on the inflation front, while the strong July employment report shows a clear improvement in the labour market. Therefore, he shares with the majority of the FOMC the view that tapering could start already this year. Yet a further spread of the Delta variant may force a delay. Evidence of its economic fallout is so far limited to surveys and high frequency indicators on services purchases, which show a levelling off in activity but not an outright contraction. The employment report for August, due in a week, will be then a crucial piece of information. We bring forward to November our expected date for the beginning of tapering, provided that the Delta variant does not disrupt economic activity, hampering job creation in services.
To tune down the hawkish tone, Powell reiterated that tapering QE is different from raising fed funds rates, and the former does not convey any specific indication on the latter. Raising rates requires first the attainment of full employment; this has a broad and not very sharp definition, but should correspond to unemployment rate at around 3.8%, judging from previous speeches by FOMC members. Moreover, inflation should reach 2% on a sustained based, as Powel repeated. Both goals are still far from being met. In the meantime, monetary policy will remain accommodative, Powell reassured.

In the speech Chair Powell summarized the economic outlook, in similar tones as after the July meeting. He acknowledged the strong improvement in the labour market, noting that 800 out of the 832k new jobs added monthly on average in the last three months were in the services sector. High levels of job opening and quits and survey evidence of labour shortages bode well for a continued streak of good employment data, once the factors hampering labour market participation fade and if the risk for the Delta variant do not materialise.

Inflation remains high but this is due to a limited number of sectors, where price increasing is moderating anyway. Broad based pressures are not on the horizon and the global trend capping inflation remains active. Yet, and quite surprisingly given past communication, the current inflation matter for the Fed target to quite a large extent. This is also due to the positive evolution of expectations. The Index of Common inflation Expectation the Fed developed has returned to level broadly consistent with the 2% target. Our nowcast for August shows another, smaller, increase.



Summing up, Powell reframed the current Fed's narrative in a more explicit, showing to a guarded optimism on the short-term risks from the new COVID strain. However, Fed's actions remain fully data driven. Given the "mission accomplished" on the (actual and expected) inflation front, only a strong setback on employment over the next couple of months could delay tapering into 2022. We stick to the view a first rate rise in 2023.

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