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# Fed March hike looks a done deal; balance sheet unwind soon after

Macro economy United States

Fed View: 'Humble and nimble' the name of the game – At its January meeting, the FOMC kept policy on hold, but – in line with our and market expectations – the Committee indicated in its statement that a rise in the federal funds rate would be appropriate 'soon', i.e. likely in March.

Its assessment of the economic outlook was broadly unchanged, with the Fed referring to inflation 'well above' its 2% target and the 'strong labour market' as driving the need for a near-term policy tightening. The Committee did acknowledge the recent rise in covid-19 cases as currently dampening activity in the pandemic-sensitive sectors (travel and restaurant dining), but in the press conference Chair Powell expressed confidence that this soft patch would not last. referring to the fact that



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impulse would also be much smaller this year, and that many factors driving inflation on the supply-side should ultimately ease as the year progresses.

At the same time, he reiterated a recent refrain in FOMC pressers calling for 'humility' in setting policy in the current environment, given the extraordinary uncertainty in the outlook and the 'range of plausible outcomes'. The Fed therefore needs to be 'humble and nimble' in adapting policy should inflation fail to fall back, or if indeed it falls back more quickly than currently projected. He did note, however, that the outlook for inflation was 'slightly worse' than at the December meeting, and that supply-side bottlenecks were still barely easing as yet.

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**Balance sheet unwind likely to begin in late Q2** – In the statement, the Committee confirmed that net asset purchases would come to an end in early March, and in a [separate statement](#) on the principles guiding balance sheet unwind, that this process would start after the fed funds rate begins rising. In the press conference, Powell clarified that the details would be worked out over the next couple of meetings, and that it would be discussed in ‘at least one’ FOMC after March, i.e. at the May meeting. This is consistent with our base case for the Fed to start the balance sheet runoff in late Q2, likely in May itself. Alongside the policy statement, the Committee published some general principles that will guide the more detailed decisions on the balance sheet going forward. Most of these were consistent with those that guided the last period of quantitative tightening, including for instance that the Fed still judges that the fed funds rate is its primary preferred policy tool. However, one interesting part for us was that the Fed appeared to leave open the possibility of outright sales of securities as part of the runoff process:

*“The Committee intends to reduce the Federal Reserve's securities holdings over time in a predictable manner **primarily** by adjusting the amounts reinvested of principal payments received from securities held in the System Open Market Account (SOMA).”*

This is consistent with recent comments by FOMC hawk Loretta Mester, who said that the Fed ‘won’t take anything off the table regarding balance sheet reduction.’ We still think outright sales of securities would be a bold move by the Fed, but with the significant risks around inflation, we would not rule it out either.

All told, we continue to expect the Fed to raise rates four times this year, with the fed funds rate reaching the pre-pandemic target range of 1.5-1.75% by mid-2023. But with inflation risks still very much to the upside, the risk is that the Fed needs to do more. In light of this, in our January Monthly we explored a potentially much more aggressive Fed scenario, which can [be read about here](#). (Bill Diviney)

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