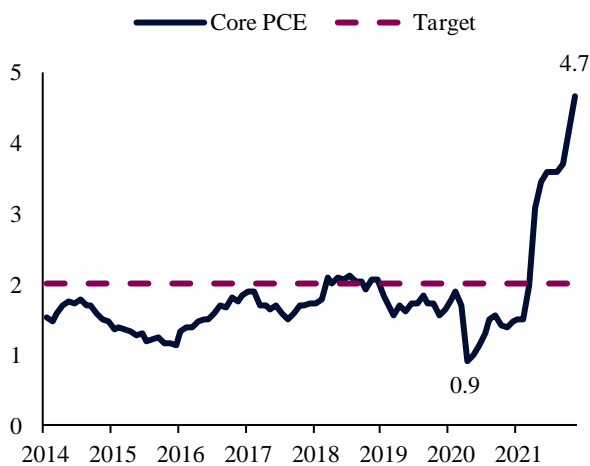


US Federal Reserve doubles down on “hawkish pivot”

The US Federal Reserve (Fed) continues to drive the economic agenda, setting the tone for monetary developments globally. In September 2021, after more than a year of extraordinary measures to support the economy following the pandemic shock, the Fed officially announced the start of its monetary policy “normalization” plan. Back then, the Fed announced a gradual reduction or “taper” of its USD 120 Bn per month long-term of asset purchases (otherwise known as quantitative easing or QE). The expectation was that net asset purchases from the Fed would reach zero by mid-2022, completing the so-called taper process.

In December 2021, however, as inflation accelerated further, the Fed started a “hawkish pivot,” communicating that elevated price pressures could justify ending QE sooner than planned. In fact, the US core personal consumption expenditures price index (PCE), the Fed favourite gauge for inflation, spiked 4.7% y/y in December 2021; again well above the 2% policy target.

US inflation
(core PCE, %, y/y)



Sources: Haver, US Federal Reserve, QNB analysis

Inflationary developments started to indicate that ultra-easy monetary policy is no longer consistent with the magnitude, breadth and pace of the US economic recovery. US GDP is estimated to have expanded by 6% in 2021. Importantly, momentum is expected to continue strong this year, with a healthy

pace of expansion in both consumption and investment propelling a GDP growth of over 5% in the US. Federal stimulus payments and social support programmes have helped to strengthen the finances of the private sector, providing a cushion of savings that are typically non-existent in the wake of a recovery. This supports high levels of consumption and activity for longer, which could lead to a multi-year period of above-trend growth.

While the US economy is still not running at full employment, given some “slack” or spare capacity in industrial production and labour markets, the growth outlook suggests that additional capacity will be filled sooner rather than later. This will increase the risks from economic overheating, eventually creating more persistent inflationary pressures.

Such risks are currently being amplified by negative developments on the supply side of key US trade partners. The spread of the Covid-19 Omicron variant in Asia, and particularly China, is starting to become a major threat to global supply chains. The current combination of a highly infectious Omicron variant with China’s “Zero Covid-19” policy could potentially lead to large-scale lockdowns and a cascade of severe shocks in supply chains and global trade. This would contribute to stress producers, create shortages and maintain prices elevated, both globally and in the US.

In light of such inflationary backdrop, Fed officials doubled down on their hawkish pivot, hinting at both an early end to QE and a much faster cycle of interest rate hikes. In recent weeks, monetary authorities even started the discussion about quantitative tightening (QT), i.e., the process of unloading some of the assets that were purchased during QE into the market. Differently than a QE taper, that only stabilizes the Fed’s balance sheet by reducing extraordinary net asset purchases down to zero; QT shrinks the Fed balance sheet with net sales of assets to the private sector. QT aims to mop up excess liquidity in the banking system, providing some much needed tightening in financial conditions.

Currently, the Fed balance sheet stands at USD 8.8 trillion, having more than doubled since the pandemic started in early 2020. During this period, excess reserves became abundant in US commercial

banks, as growth in their cash holdings (132%) far outpaced their total asset growth (28%). Therefore, as banks are awash with liquidity, Fed assets can be more easily absorbed without causing undue market disruptions. Less abundant liquidity will contribute to tame asset price inflation which, indirectly, via financial and commodity markets, feeds into consumer price inflation.

All in all, the hawkish pivot is gaining momentum. In our view, QE taper will be completed in Q1 2022 and rate hikes will start as early as March. We expect four 0.25% rate hikes in 2022, one per quarter. QT should slowly start shortly after the first rate hike, potentially accelerating over Q2 and Q3.

QNB Economics Team:

James Mason
Senior Economist
+974-4453-4643

Luiz Pinto*
Economist
+974-4453-4642

Mingjie Tang
Economist
+974-4453-4736

* Corresponding author

DISCLAIMER: *The information in this publication (“Information”) has been prepared by Qatar National Bank (Q.P.S.C.) (“QNB”) which term includes its branches and affiliated companies. The Information is believed to be, and has been obtained from, sources deemed to be reliable; however, QNB makes no guarantee, representation or warranty of any kind, express or implied, as to the Information’s accuracy, completeness or reliability and shall not be held responsible in any way (including in respect of negligence) for any errors in, or omissions from, the Information. QNB expressly disclaims all warranties or merchantability or fitness for a particular purpose with respect to the Information. Any hyperlinks to third party websites are provided for reader convenience only and QNB does not endorse the content of, is not responsible for, nor does it offer the reader any reliance with respect to the accuracy or security controls of these websites. QNB is not acting as a financial adviser, consultant or fiduciary with respect to the Information and is not providing investment, legal, tax or accounting advice. The Information presented is general in nature: it is not advice, an offer, promotion, solicitation or recommendation in respect of any information or products presented in this publication. This publication is provided solely on the basis that the recipient will make an independent evaluation of the Information at the recipient’s sole risk and responsibility. It may not be relied upon to make any investment decision. QNB recommends that the recipient obtains investment, legal, tax or accounting advice from independent professional advisors before making any investment decision. Any opinions expressed in this publication are the opinions of the author as at the date of publication. They do not necessarily reflect the opinions of QNB who reserves the right to amend any Information at any time without notice. QNB, its directors, officers, employees, representatives or agents do not assume any liability for any loss, injury, damages or expenses that may result from or be related in any way to the reliance by any person upon the Information. The publication is distributed on a complementary basis and may not be distributed, modified, published, re-posted, reused, sold, transmitted or reproduced in whole or in part without the permission of QNB. The Information has not, to the best of QNB’s knowledge, been reviewed by Qatar Central Bank, the Qatar Financial Markets Authority, nor any governmental, quasi-governmental, regulatory or advisory authority either in or outside Qatar and no approval has been either solicited or received by QNB in respect of the Information.*