The increasingly hawkish FOMC faces uncertainties

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21 FEBRUARY 2022
(ORIGINAL JAPANESE VERSION RELEASED ON 1 FEBRUARY 2022)

At the Federal Open Market Committee (FOMC) meeting held on 25th and 26th January, the Committee suggested in its Statement that it will carry out an interest rate hike at its next meeting, and the contents of its Principles for Reducing the Size of the Federal Reserve's Balance Sheet* published after the meeting were generally in line with expectations. On the other hand, Chair Powell's attitude during the press conference after the meeting was more hawkish than predicted. When asked about the possibility that the Fed will hike rates at every meeting or will raise the target range for the federal funds rate by 0.5% points at a time, Chair Powell repeatedly emphasised that inflation is at elevated levels and the labour market is tight, and he did not rule out the possibility that rates would be raised at this kind of pace.

There has not been a combination of high levels of inflation and a tight labour market since the rate hike cycles of 1980s (Chart 1, upper). It appears that a pace of rate hikes that is faster than last time (roughly 0.25% points every three months) would be sufficiently justified.

That being said, there is also some uncertainty about the effects of raising interest rates. Firstly, the tight labour market (and inflationary pressure caused by wages) seems to be mainly caused by issues on the supply side given the high rate of job openings (Chart at1, lower), and the impact of a rate hike would probably be limited. Secondly, if interest rates are hiked at a pace like the one mentioned above, which is higher than financial markets have factored in, this will raise concerns about an economic recession in the future and, conversely, it is possible that it will result in a situation where long-term interest rates struggle to rise. During the phase of rate hikes from June 2004, long-term interest rates did not rise at the start, something that the chair of the Fed at that time, Alan Greenspan, referred to as a "conundrum". Meanwhile, there was an accumulation of outstanding mortgage debt. Currently, although the rise in mortgage debt has been limited, the rate of home price increases is now at the level it was at before the financial crisis (Chart 2, lower) and there is increasing room for adjustment.

Looking ahead, even if the FOMC maintains its hawkish stance, a further increase in long-term interest rates may be limited. It will be important to keep an eye on the risk of an accumulation of imbalances in terms of financial position and asset price.

*Principles include, "the Committee views changes in the target range for the federal funds rate as its primary means of adjusting the stance of monetary policy", "the Committee intends to reduce the Federal Reserve's

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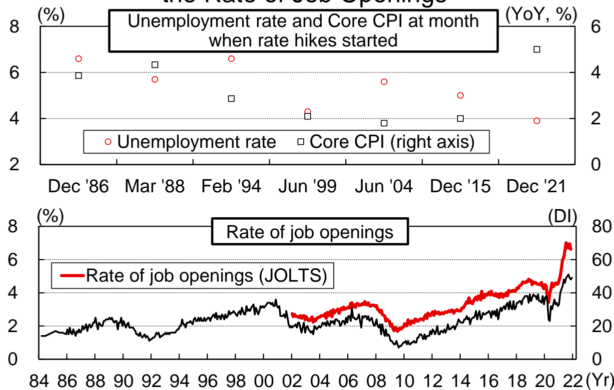
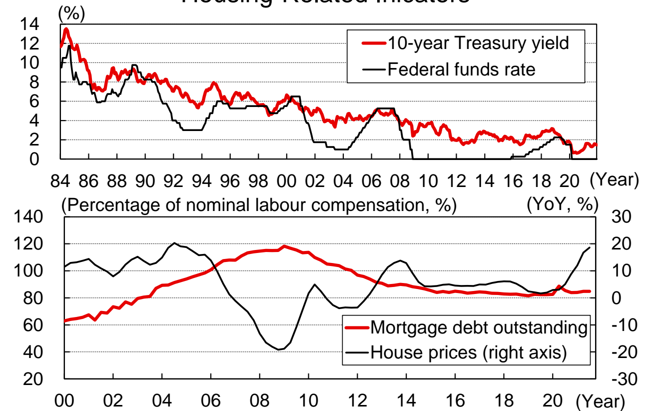
holdings over time in a predictable manner primarily by adjusting the amounts reinvested of principle payments received from securities held in the System Open Market Account (SOMA)" and "in the longer run, the Committee intends to hold primarily Treasury securities in the SOMA"

Chart 1: Unemployment Rate, Core CPI and the Rate of Job Openings



Note: Core CPI is a quarterly average including the month when rate hikes start
Source: US Bureau of Labor Statistics, National Federation of Independent Business, MUFG Bank Economic Research Office

Chart 2: 10-Year Treasury Bond Yield, FF Rate, Housing-Related Inicators



Source: Bloomberg, Federal Bank of New York, S&P, MUFG Bank Economic Research Office

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