



## Daily Macro Insights: The Fed tightening two-step

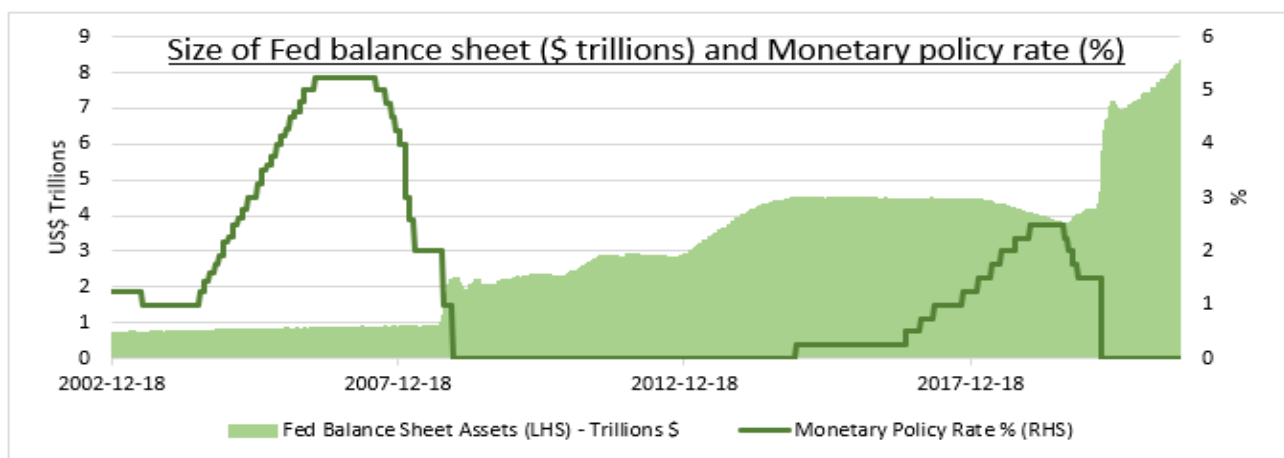
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**JACKSON HOLE:** The US Fed's online 'Jackson Hole' get together starts today, with markets anxious for any clues of the road to tighter policy. We don't expect a firm tapering decision until the Sept. 21-2 Fed meeting at earliest. Tightening will be slow, well telegraphed, and markets able to absorb. But we are in uncharted territory and volatility is likely to increase.

**FED TWO-STEP:** The Fed balance sheet has ballooned to \$8.3 trillion, double its size before the pandemic. Similarly, the Fed funds rate is at zero, for only the second time. The Fed tightening two-step is to 1) cut ('taper') its \$120 billion a month bond purchases to zero by mid-late 2022. This will slow and then end its balance sheet growth, which then naturally falls as bonds mature. They are unlikely to sell anything. 2) Fed then slowly raises 0% Fed funds interest rate, starting end 2022/early 2023, depending on inflation and GDP outlook.

**MARKET IMPACTS:** This is uncharted territory with the Fed balance sheet never this big or interest rates this low. Therefore, the Fed will move slowly and transparently, and only as the economy supports. We think the history of bond market surprises and '[tantrum](#)' fears are overdone. Equities performed well around the 2013 'tantrum' and in Q1 this year when [bond yields](#) spiked. Tapering, alongside robust growth recovery, likely drives higher bond yields. This hurts valuation and drives some sector rotation to Value. But yields will still be a fraction of the 4%+ after the last two recessions, and still support high equity valuations.

**TODAY:** Hidden in the updated US Q2 GDP report today will be that of corporate profits, for the first time. This will give a broad sense of the profit rebound we see continuing, not just the big surprise already seen from the S&P 500. Consensus is +27% year over year growth.



Source: FRED, Refinitiv

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