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Macro Alert

Weak Data and Fiscal Uncertainty Will Delay Fed Tapering

From the Office of the Global Chief Investment Officer, Scott Minerd

By the Macroeconomic and Investment Research Group

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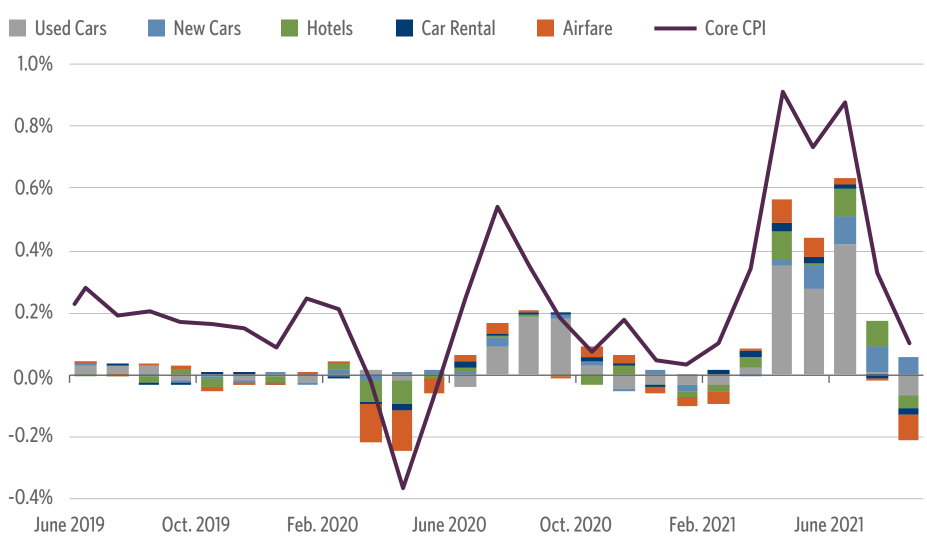
The Federal Reserve (Fed) has been trying to clear the runway for a tapering announcement, but recent economic data have thrown a wrench in that plan. August payroll gains came in nearly 500,000 less than expected amid the Delta-driven COVID surge. September payrolls could also disappoint given that restaurant activity, the primary driver of recent job growth, has shown continued weakness since August.

The Delta effect was also evident in the August CPI data. The categories we have highlighted as transitory were again the main story, but this time to the downside. Travel sectors saw large price declines amid the Delta surge, with airfares, hotels, and car rental prices declining. Used car prices also fell, as we've been expecting.

Transitory Categories Now Pulling Core CPI Down

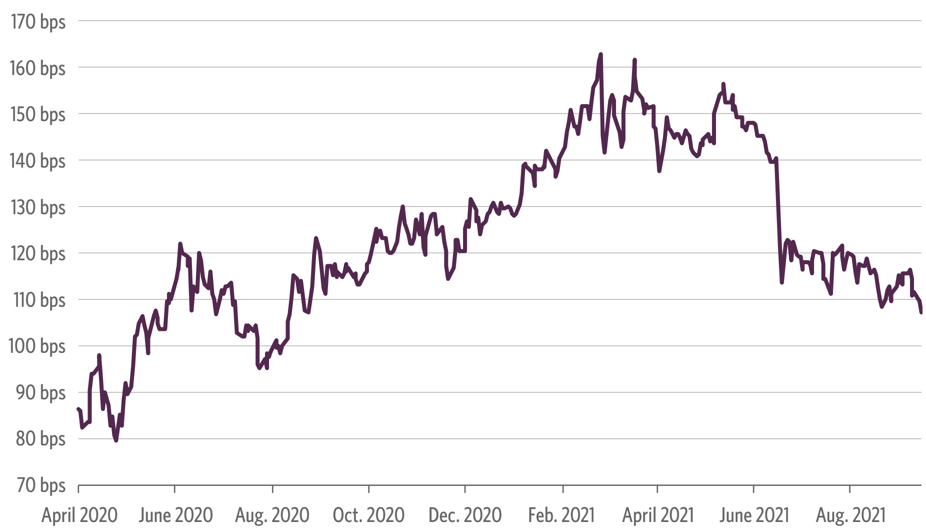
Core CPI, Contribution to MoM% Change



Source: Guggenheim Investments, Haver Analytics. Data as of 8.31.2021.

Markets appear to have gotten the inflation-is-transitory message. The long end of the yield curve is now flatter than it was in August 2020 when Chair Powell unveiled the Fed's new policy strategy.

The Flattening Long End of the Yield Curve Indicates Reduced Inflation Expectations
5y30y Treasury Yield Curve



Source: Guggenheim Investments, Bloomberg. Data as of 9.14.2021.

More downside data surprises could be in store. Third quarter real gross domestic product (GDP) tracking has fallen to 3.3 percent, and as the return to school sparks more COVID spread, consumption could take another hit.

As we previously warned, weaker data makes a taper announcement at next week's FOMC meeting unlikely. An announcement at the November 2-3 meeting now seems to be the market's base case, but upcoming drama in Washington could affect that decision. The debate over the debt ceiling is shaping up to be contentious, which will be further complicated if the debt ceiling gets tied in with a government funding bill to avoid a shutdown at the end of this month. Democrats have said they will not unilaterally raise the debt ceiling, while 46 Republican senators have pledged to not vote for it, leaving no clear path forward.

Ultimately, one side will blink to avoid defaulting, but financial market jitters and possible economic disruptions from a government shutdown could cause the Fed to hold off on a tapering announcement in November. In our view, this makes a December announcement the most likely outcome. Such a delay would reinforce our view that the Fed will be cautious on normalizing policy, and that the economic recovery is unlikely to proceed smoothly enough for the Fed to hike rates by early 2023 as currently priced in. The upshot is that bond yields could fall further as a patient Fed and rising fiscal risks get priced in.

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