

Chart of the Day

An assessment of Fed tightening policy begins with the recognition that they doubled their balance sheet to \$9 trillion during the two year COVID-crisis (see chart below).

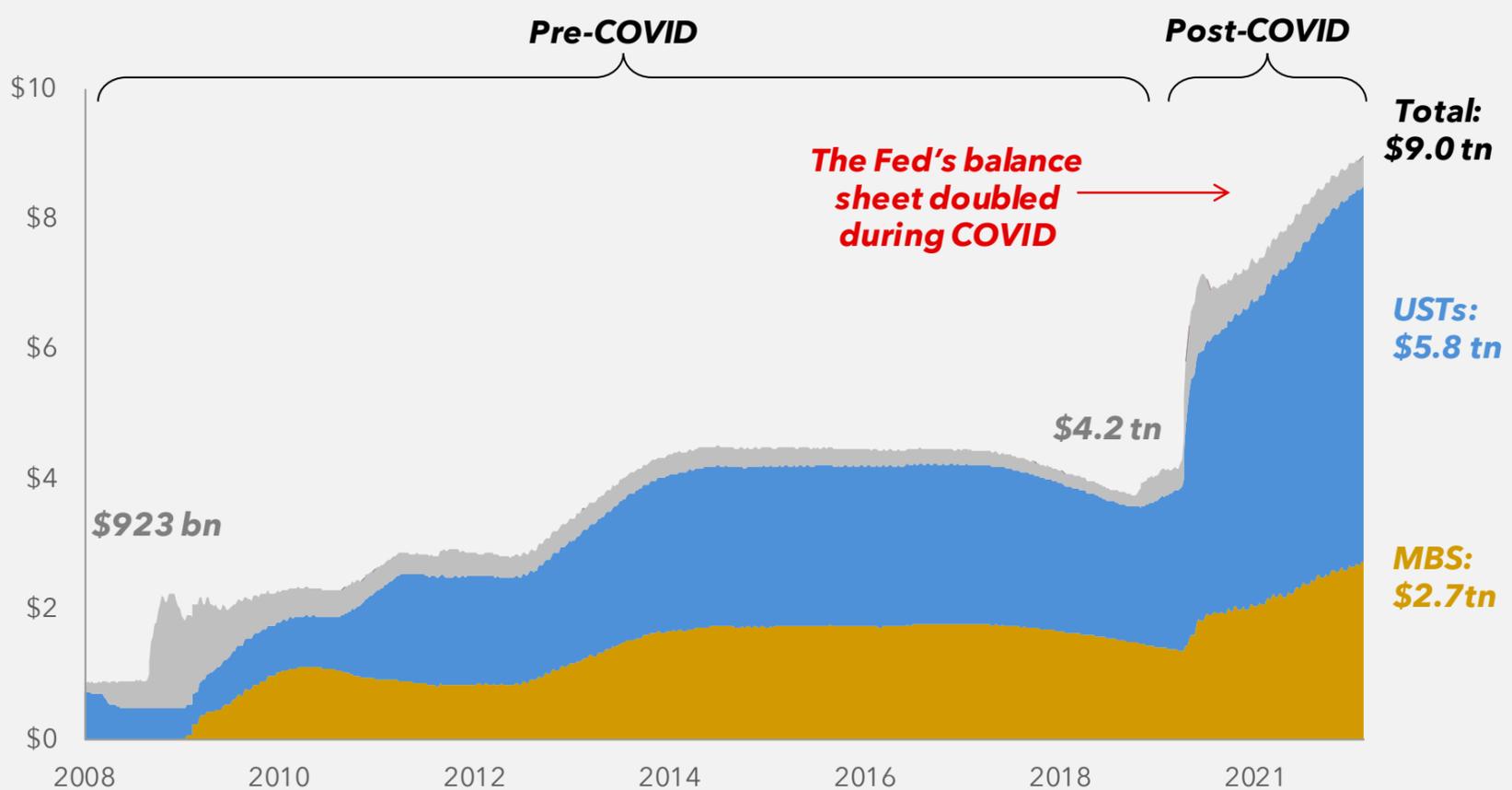
Fed minutes yesterday revealed a slightly slower pace of QT than expected by many (especially given Governor Brainard’s hawkish comments on Tuesday). **While the pace of QT may be lighter than anticipated** - \$95n per month with monthly caps of about \$60bn for Treasuries and \$35bn for agency MBS - **the start date may be sooner than expected**, with a three month phase-in period beginning in May. Since monthly run-off on agency MBS is unlikely to reach the cap targets, the Fed has indicated it may be appropriate to consider sales of MBS as needed.

Fed minutes also suggested the possibility of 50bps rate increases at multiple upcoming FOMC meetings, noting that they would have done so at the March 16 meeting as well, had it not been for the uncertainty of the Ukraine invasion.

Forecasting Fed decision-making is an enormous challenge, especially when the Fed itself has low visibility on its path. **When is the last time the Fed faced policy rates near zero, 8% inflation and a systemically significant global geopolitical event?** Never before. **When is the last time the Fed commenced an accelerated tightening cycle after a major equity market correction and an inversion in the yield curve?** It hasn’t.

The Fed’s quandary extends from both its late start (“behind the curve”) and the bluntness of its demand-side toolkit (rate hikes and QT) for a largely supply side problem - COVID (China lockdowns) and CONFLICT (Ukraine crisis). With growth rapidly decelerating before QT and 50 bps rate hikes have even begun, the Fed will likely struggle to engineer a “soft landing” without policy error. **The Fed is right to prioritize rising inflation over decelerating growth, but how long will they be able to do so?**

Fed balance sheet total assets, USD tn



Source: (1) Bloomberg. Data as of April 7, 2022. FRED.

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