# Fed Shifts Gears, Slashes Bond-Buying in Half as it Prioritizes Inflation Over Employment

**Critics have suggested the central bank has fallen behind the curve in tackling surging inflation.**

By Tim Smart
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For nearly two years, the Federal Reserve has accepted a high rate of inflation as it argued that a pandemic-ravaged labor market still needed time to heal.

No more. On Wednesday, the Fed agreed to accelerate the pace at which it withdraws the extraordinary support it has provided to the economy since the coronavirus arrived in 2020 through its $120-billion-per-month purchases of Treasuries and mortgage-backed securities.

After announcing a reduction of $15 billion a month in November and a similar reduction this month, the Fed will now shave those purchases by another $30 billion, cutting its original amount of purchases in half, to $60 billion. The Fed has already retired the use of the term “transitory” to describe consumer inflation that is running at a 6.8% annual rate and now is poised to begin raising interest rates as early as next year.

The Fed’s projections, also released Wednesday, show officials foresee three rate hikes next year with more in 2023 and 2024.

It’s a gamble that the economy is strong enough to stand on its own two feet, and with the annual rate of growth in the nation’s gross domestic product likely to exceed 5% for 2021, it appears the time is right. But with supply chain disruptions continuing and severe shortages of labor in many industries, some fear the Fed has fallen behind the curve.

“While the term ‘transitory’ is now verboten in the Fed’s lexicon, our projection does show inflation cresting by 2Q 2022 and then ‘transitioning’ to 3.5% by the end of year,” **Bernard Baumohl, chief global economist at the Economic Outlook Group,** wrote ahead of the meeting Tuesday.

He adds that a drop in energy prices, the increased spread of vaccinations and an improvement in clogged supply chains could result in a slowing of inflation next year.

“Even if all these three positive developments materialize, they will still not dissuade the Fed from proceeding with a lift-off in rates next spring. The chorus of complaints claiming (Fed Chairman Jerome) Powell is already behind the curve has gotten louder and – despite all his past utterances of being solely data dependent – those public warnings do have an effect,” **Baumohl** added.

In a press conference after the announcement, Powell said the economy has made “rapid progress toward maximum employment” and that the unemployment rate could reach 3.5% by the end of next year. That would bring it back to the record low rate it achieved in February 2020. He also indicated the asset purchases would end after the Fed’s next two meetings.

“The real economy is booming and can absorb a gradual and orderly pace of policy normalization,” tweeted RSM US Chief Economist Joseph Brusuelas.

Aoifinn Devitt, chief investment officer at advisory firm Moneta, says markets and consumers should not be surprised by the Powell “pivot” toward a less accommodative monetary stance.

“This, to me, has been very well telegraphed,” she says, adding that markets have shown “stubborn resilience” in the face of possible higher interest rates. As for inflation, she sees that continuing to be an issue in 2022.

“Looking into next year, I do expect inflation to be elevated,” she says.

Various polls show inflation is now the primary concern of Americans, having displaced the coronavirus as top of mind. An analysis of the consumer price index for November by the Penn Wharton Budget Model released Wednesday finds the average household will spend $3,500 more in 2021 to maintain the same level of consumption as in 2020 or 2019.

Penn Wharton noted that prices used to compute the index vary widely.

“For example, the price of food rose by 6.1 percent compared to a year ago, while the average energy price jumped by 33.3 percent,” the analysis concluded.

“There was also a noticeable difference between commodities and services. While the one-year price increases for shelter and other services (excluding energy services and shelter) were 3.8 percent and 2.9 percent respectively, the price

increase for commodities (excluding food and energy commodities) was 9.4 percent," Penn Wharton found.

In general, markets took the news in stride with the Dow Jones Industrial Average up more than 100 points.

"Investor confidence in the Fed's handling of monetary policy is very important as we enter a new era of higher interest rates," says Chris Gaffney, president of world markets at TIAA Bank. "Today's meeting shows the FOMC definitely has an eye on both of their mandates and will adjust policy to keep the US recovery on track. This is good news for markets, investors and consumers as we move into the new year."

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