

## Rock, scissors, taper

In trying to avoid talking about a taper, the Fed may be increasing the chances of a taper tantrum compared to what would happen if they were more open



rock paper scissors

Source: shutterstock

## A horse walks into a pub...

Don't you just love central banks? Yesterday the FOMC met and James Knightley [has written a brilliant note together with our FX and rates colleagues](#) (Chris Turner, Padhraic Garvey) - where he cites the risk of an earlier rate move than the current dot-plot suggests (2023 rather than 2024), and raises the prospects of a taper before year-end, though wrapped around some twist operations to prevent the longer-end of the yield curve from rising. If left open-ended, this would not be far off a yield curve control (YCC) exercise, though YCC seems to be increasingly a dirty phrase in central bank circles, so they will no doubt come up with a more palatable expression for this nearer the time. I was toying with "managed withdrawal", but this conjures up images of people queuing up outside their local pharmacy for a beaker of methadone (or worse), and I'm sure I can do better.

Knightley's forecasts partly stem from the looming pick up in US inflation due over the middle of 2021, but also the fact that US households are sitting on unprecedented piles of liquid cash in cheque and savings deposits. This is a combination of enforced savings by the wealthy who are

unable to spend on services/experiences as they would normally do when the economy was not in lockdown, and government support cheques at the lower-income scales, which have also been partly saved. All of this sets the scene for a strong recovery this year based on pent up demand as the vaccine rollout progresses and the US re-opens. GDP growth of 5% in the US is a possibility (says Knightley) this year if so.

## It's behind you ("Oh no it isn't!")

But to read the Fed statement and then listen to the press conference, you'd think the word taper didn't even exist. Do the people that advise Powell and other senior Fed speakers seriously think that not talking about taper now will make the eventual "big-reveal" less traumatic? Or, do you believe (as I do), that by trying to steer the market to an alternative view, the eventual admission will be much more likely to lead to a shocked sell-off? Answers on a post-card please (or e-mail).

I know US growth right now looks weak, and that will likely be re-emphasized by the 4Q20 US GDP numbers released later today (4.2% annualized rate expected by consensus, down from 33.4%), but markets aren't stupid, and neither are forecasters. The future does indeed look a lot brighter.

In any case, bond markets are being driven more today by a nasty equity sell-off, which has taken the 10Y UST yield down to only a bit over 1.0%. Against this lower yield environment, the USD is no longer seeming to be driven by yields but is gaining in a more risk-off environment. This was particularly evident against the AUD and NZD this morning, which are being battered. The NZD has taken an extra kicking from some weaker-than-expected December trade figures which have all but eliminated the trade surplus.

Other currencies in the region are losing ground to the USD too. The offshore renminbi has weakened sharply back above 6.50 and USDKRW has shot higher this morning reaching 1114. We will be looking at our forecasts for Asian FX today and there is a good chance we will be scaling back the appreciations previously penciled in, ahead of any prospective retreat from our aggressive EURUSD forecasts.

## Asia today

Business sentiment indicators from South Korea already released showed an improvement in both manufacturing and service sectors, which is an encouraging backdrop for this quarter's production and GDP expectations. At 81, the Manufacturing index has recovered to roughly pre-Covid levels, though at 70, the services index still has some way to go before we can declare recovery.

Most of the other Asian data out today is from SE Asia, [and is covered in our sister publication, ASEAN Bytes](#), where we look at Philippine 4Q GDP (expected very weak), as well as Indonesia's budget tweaks and Singapore unemployment (should improve).

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