Philequity Corner (November 8, 2021)
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Dovish taper

Last week, the Fed announced that it will start tapering its bond purchases. Despite elevated inflation, Fed Chair Jerome Powell stressed that there will be no interest rate hikes yet. The announcement of a dovish taper drove the S&P 500, Dow, Nasdaq, and Russell 2000 to fresh record highs. This consequently sparked a strong rise in other global benchmarks. Following the lead of US stocks, the PSEi gained 1.9% last Friday on strong foreign buying.

Tapering but not tightening

As expected by many investors, the Fed said last week that it will reduce its purchases of US Treasuries by $15 billion per month. At this pace, the Fed is on track to end its bond-buying program by the middle of next year, but Powell noted that the pace may be altered depending on the outlook. Though the Fed has initiated the tapering process, Fed officials were unanimous in voting to keep the Fed funds target range at 0% to 0.25%. As explained by Powell, the Fed is tapering its bond purchases but is not yet tightening its monetary policy.

Elevated inflation driven by transitory factors

Members of the Federal Open Market Committee (FOMC) justified their decision to refrain from raising rates. In its policy statement, the FOMC said, “Inflation is elevated, largely reflecting factors that are expected to be transitory. Supply and demand imbalances related to the pandemic and the reopening of the economy have contributed to sizable price increases in some sectors.” Powell conceded that the inflationary impact of the supply-chain bottlenecks was bigger-than-expected. Nonetheless, he believes that the economy will adjust and correct the imbalances brought by supply-chain disruptions. Meanwhile, European Central Bank (ECB) Christine Lagarde said that the ECB was very unlikely to hike rates next year. The ECB views rising inflation as a temporary shock which arose because of pent-up demand.

Inflation vs. employment

US headline inflation averaged 4.4% in the last 12 months ending September. This is the highest in three decades and is more than double the Fed’s target. Nonetheless, Powell remained steadfast in the Fed’s decision not to raise its benchmark rate. Powell remarked, “We don’t think it is a good time to raise interest rates because we want to see the labor market heal further.”

Last Friday, the US announced that it added 531,000 nonfarm jobs in October. Unemployment rate went down from 4.8% to 4.6%, the lowest since the start of the pandemic. However, this is still markedly higher than the pre-crisis level of 3.5%. Powell believes that “there is still ground to cover to reach maximum employment.” Based on Powell and the Fed’s statements, we can deduce that sustaining labor market gains is a more important goal for them than taming inflation at this point in time.

Liftoff to commence only when needed

The end of the Fed’s bond-buying program may coincide with the consensus expectation of two rate hikes beginning mid-2022. Based on the Fed’s September outlook, nine of the 18 Fed members expect a rate hike next year. However, Powell underscored that the liftoff, or the Fed's first interest rate hike, will only happen if it is warranted by the economic outlook. Powell added, "We think we can be patient. If a response is called for, we will not hesitate."

US stocks make new highs on Fed assurance

Wary of the risks posed by higher inflation, investors were reassured when Powell said that the Fed is ready to act if needed. In addition, the Fed and other major central banks reiterated their continued support for the fragile recovery. These address the concerns of investors that central banks may either stifle the recovery by raising rates prematurely or may respond too late in taming inflation. Markets reacted positively to the supportive statements of central banks. All four major US indices closed at new all-time highs last week due to the announcement of a dovish taper. The S&P 500, Dow, Nasdaq, and Russell 2000 posted weekly gains of 2%, 1.4%, 3.1%, and 6.1%, respectively. The Russell 2000 is composed of 2,000 small-cap US companies.

Diokno to keep stimulus in place

Last Friday, the *Bangko Sentral ng Pilipinas (BSP)* announced that headline inflation eased to 4.6% in October from 4.8% in September. This resulted in a year-to-date average of 4.5% and was above the government's 2-4% target range. The central bank said that it will "closely monitor all risks to future inflation and will remain vigilant against the emergence of second round effects and any possible unhinging of inflation expectations."

BSP Governor Ben Diokno said that the inflation outlook remains manageable due to non-monetary measures implemented by the government to address supply bottlenecks. In this light, he emphasized that "the priority for monetary policy remains in keeping stimulus in place to aid the recovery." Diokno maintained that the central bank "stands ready to respond to potential second-round effects from supply-side factors as well as to more broad-based inflation pressures as the economy makes a full recovery."

Strong week for PSEi

The PSEi advanced 4.1% last week due to the bullish move of global markets. Aside from this, the PSEi's impressive weekly gain came on the back of the lowering of Metro Manila's alert status to Alert Level 2. This permits business establishments to operate at higher capacities while also allowing a wider range of economic activities. Moreover, domestic inflation eased in October while Diokno and the BSP delivered reassuring policy statements. These local developments drove the PSEi's robust weekly performance and enabled it to track the ascent of the US stock market and other global equity indices.