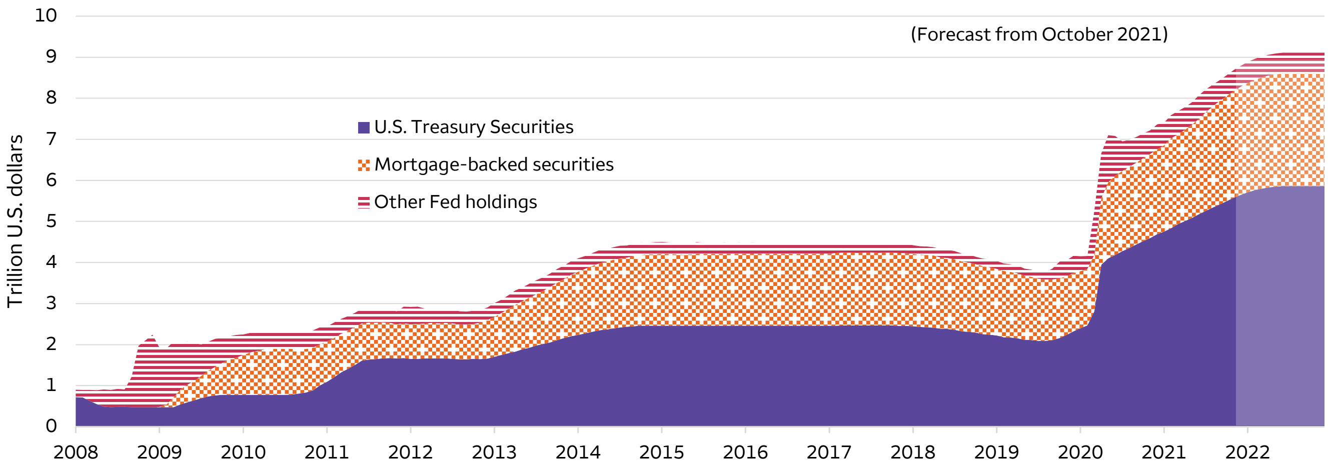
WELLS FARGO
Investment Institute

Chart of the Week

Weekly market analysis on key market indexes November 9, 2021

The Fed pulls back on bond purchases — What's next?



Sources: Federal Reserve and Wells Fargo Investment Institute. Latest data as of September 30, 2021. Forecasts from October 2021 through December 2022 are based on our estimates and the Federal Reserve's announced pace of tapering. These may be subject to change based on market and macroeconomic developments.

The Fed's balance sheet before tapering and after tapering (projected, lighter shading)

The Federal Open Market Committee (FOMC) announced last week that it would reduce its monthly purchases of U.S. Treasury securities (USTs) and mortgage-backed securities (MBS). Since mid-2020, the Federal Reserve (Fed) has been buying bonds at a rate of $120 billion per month, split between $80 billion in USTs and $40 billion in MBS. The Fed had said that it would maintain this purchase pace until "substantial progress" had been seen in meeting the central bank's inflation and employment objectives. With last week's announcement, the Fed effectively declared that these criteria had been met.

The Fed announced that it will reduce purchases by $15 billion each month in November and December — cutting UST purchases by $10 billion and MBS purchases by $5 billion. Assuming that tapering continues at $15 billion per month, the tapering process will last eight months, and the Fed will no longer be buying bonds by June 2022.

What it may mean for investors

We expect longer-maturity U.S. Treasury yields to rise, driven as much by the continued economic recovery and higher inflation rates as by the reduction in Fed demand from tapering. We believe that any such rise will remain moderate by historical standards.

The Fed has stated that the federal funds rate target will not increase until tapering is complete. However, the Fed may raise rates in the second half of 2022 should the risks of higher inflation become more acute.

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This chart was excerpted from the *Institute Alert*, "Fed announces tapering of bond purchases," dated November 3, 2021.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

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