Fed Unfiltered

4/26/22

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- *Inflation –It's what keeps the Fed up at night.*
- *QT – Mystery Solved: Ample reserves is $4.9TN.*
- *YC Inversions – Three is better than one.*

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Rate Hikes – The Slaying of Inflation Expectations
- The FOMC meets next week (May 3-4) – a 50bp rate hike is widely expected – a 75bp rate hike has been mentioned, although 75bps would likely surprise markets, which the Fed would be averse to doing.
- The neutral rate (approximately 2.50%) by YE22 appears to be the Fed's general goal (as mentioned by several FOMC members).
  - March's SEP puts the neutral rate at 2.40%.
- With six FOMC meetings to go before YE22, 200bps of hikes equals two 50bp hikes & four 25bp hikes.

Inflation – Here's what the Fed is Most Worried About
- "Long periods of high inflation, even if it is projected to come down, can seep into expectations, leading people to anticipate further price increases. This is especially salient now, with prices for food and gas making headlines. Research tells us that these prices heavily influence consumers' beliefs about future inflation."
- "The longer realized inflation remains high, the more risk there is that rising prices will become part of public psychology. And once psychology shifts, it is hard to bring it back."
- "We learned this lesson the hard way. The last time we experienced this kind of elevated inflation was in the 1970s—some of us remember that time. Americans faced a steady drumbeat of rising prices that lasted for over a decade. By the early 1980s, high inflation had become firmly entrenched in the public's psyche. To get things under control, the Fed had to implement a series of steep interest rate hikes. They worked, but the correction was painful."
- "This is a history no one wants to repeat. And it's why the Fed is taking actions today, far earlier than in the 1970s, to tighten policy, rebalance demand and supply, and ensure that both of our dual mandate goals are achieved."

Source: SF Fed, Daly speech, Steering Toward Sustainable Growth, 4/22/22

QT – Soon to Start, but Where Might it End?
- "For concreteness here, we consider a set of scenarios which can give a general perspective on the way the Fed's balance sheet might evolve in the next few years."
- "The Fed has expressed its intention to maintain an ample level of reserves as part of its preferred method of monetary policy implementation … we find that the pace of normalization described in the March minutes will have reserves reaching their minimum level consistent with "ample" sometime in 2025."
- "Importantly, the plan recognizes that after balance-sheet runoff is well underway, it may become relevant to consider sales of MBS to enable progress towards a longer-run SOMA portfolio composed primarily of Treasuries."
- "The last two columns of Table 1 suggests that, at the proposed pace, it would take three to four years to shrink the Fed's balance sheet to something equivalent to 20 percent of GDP, a number that is often considered a reasonable target."
  - Scenario 1 – 3mo phase in of $60/$35BN caps.
  - Scenario 2 – no phase in of $60/$35BN caps.
  - Scenario 3 – Scen 2, w/ more MBS reductions.

Table 1: Balance Sheet Projections

		Treasuries		MBS & Agency Debt		Total	
		In Trillions	*% of SOMA*	*In Trillions*	*% of SOMA*	*In Trillions*	*% of GDP*
Initial	0-yr	$5.681	67.7%	$2.716	32.3%	$8.397	34.6%
Scenario 1	2-yr	$4.428	66.7%	$2.211	33.3%	$6.639	25.3%
	3-yr	$3.708	65.5%	$1.951	34.5%	$5.659	20.8%
	4-yr	$3.235	65.3%	$1.717	34.7%	$4.952	17.5%
Scenario 2	2-yr	$4.361	66.4%	$2.211	33.6%	$6.572	25.1%
	3-yr	$3.641	65.1%	$1.951	34.9%	$5.591	20.5%
	4-yr	$3.208	65.1%	$1.717	34.9%	$4.925	17.4%
Scenario 3	2-yr	$4.361	68.0%	$2.056	32.0%	$6.417	24.5%
	3-yr	$3.641	68.2%	$1.696	31.8%	$5.337	19.6%
	4-yr	$3.208	70.6%	$1.336	29.4%	$4.545	16.0%

Sources: Federal Reserve Bank of New York, FRED and authors' calculations.
Note: A benchmark growth rate of 4 percent for nominal GDP is used.

Source: Richmond Fed, Projecting the Evolution of the Fed's Balance Sheet, 4/22/22

YC Inversions – Three Inversions is Better than One
- "The spread between the 10-year yield and the 2-year yield, the spread between the 10-year yield and the 3-month yield, and the spread between the 18-month forward 3-month yield and the 3-month yield have all been referenced recently. These indicators all turned negative, or nearly so, before each of the last three recessions. However, they now disagree, with the spread between the 10-year yield and the 2-year yield close to negative territory, signaling a possible recession, while the other two indicators are positive and in fact increasing."

Source: SF Fed, Fed Views, 4/21/22

Quote of the Week
"The first problem for all of us, men and women, is not to learn, but to unlearn." --- Gloria Steinem

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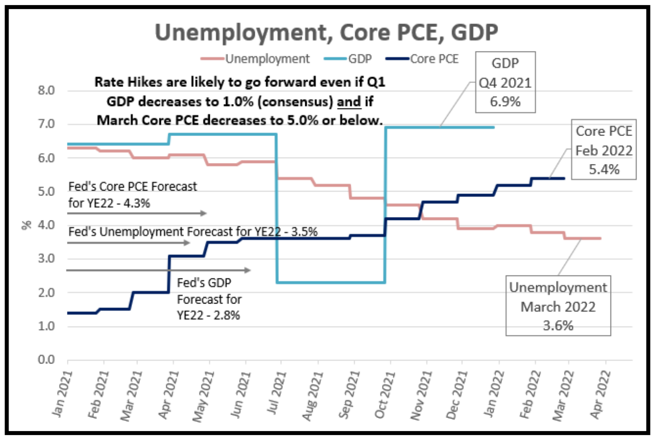
Economic Indicators:

- Unemployment: 3.6% Mar (Fed's Long Run Rate: 4.0%)
  - Apr's unemployment #'s to be released 5/6/22.
- Core PCE: 5.4% Feb (Fed's Avg. Inflation Target: 2.0%)
  - Dallas Fed's Trimmed Mean for Feb: 3.63%,
    - Trims off the lower & upper data spikes.
  - St Lou Fed 5yr Breakeven Inflation Rate: 3.25%.
    - Yield on Treasury minus yield on TIPS.
  - March's Core PCE will be released Friday.
    - Base effects might cause inflation to decrease in March, possibly to sub 5.0%.
- GDP: 6.9% Q4 (3rd Est.) (Fed's Longer Run Rate.8%)
  - Q1 GDP (Adv Estimate) to be released Thursday.
    - Median consensus is for 1.0% growth in Q1.

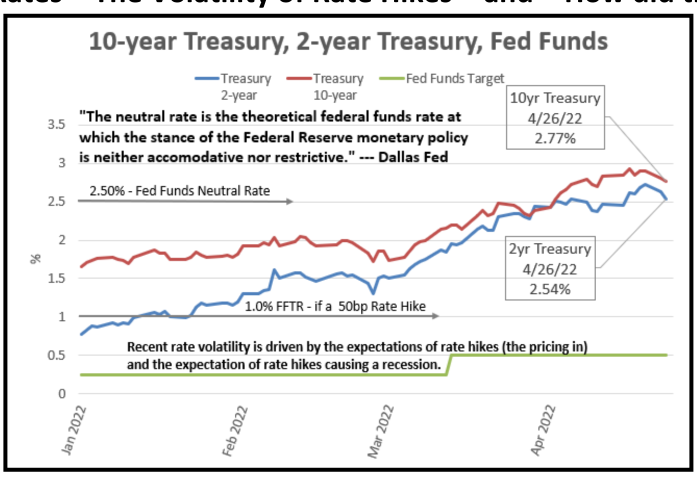


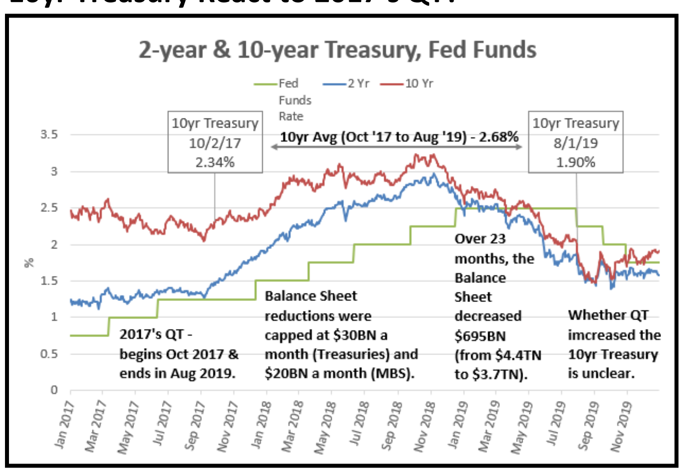
Rates --- 10-Day Trends

Borrowing Rates - Tax Exempt	4/12/22	4/13/22	4/14/22	4/18/22	4/19/22	4/20/22	4/21/22	4/22/22	4/25/22	4/26/22	10-Day Average	10-Day Avg vs 4/26/22	10-Day Change
2-Year Line of Credit (Fixed Rate Line of Credit)	3.55	3.44	3.39	3.52	3.52	3.59	3.63	3.73	3.63	1.34	3.33	(1.99)	(2.20)
10-year Term Loan 10-year Draw to Term Loan (Fixed Rate Draw Period)	3.95	3.88	3.82	3.96	3.98	3.98	4.01	4.07	3.97	1.74	3.74	(2.00)	(2.21)
15-year Term Loan 15-year Draw to Term Loan (Fixed Rate Draw Period)	4.20	4.15	4.10	4.23	4.26	4.25	4.26	4.31	4.22	1.98	4.00	(2.02)	(2.23)

Key Interest Rates	4/12/22	4/13/22	4/14/22	4/18/22	4/19/22	4/20/22	4/21/22	4/22/22	4/25/22	4/26/22	10-Day Average	10-Day Avg vs 4/26/22	10-Day Change
Federal Funds (Target Range - Upper Limit)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.00	0.00
Interest on Reserve Balances (IORB) (Formerly IOER - name changed July 2021)	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.00	0.00
BSBY - Overnight	0.322	0.322	0.322	0.320	0.324	0.325	0.329	0.330	0.331	0.331	0.326	0.005	0.009
BSBY - 1-month	0.401	0.405	0.431	0.456	0.443	0.458	0.486	0.534	0.560	0.589	0.476	0.112	0.188
SOFR - Overnight	0.290	0.290	0.290	0.290	0.280	0.270	0.260	0.270	0.270	0.000	0.281	(0.011)	(0.020)
SOFR - 30-Day Average	0.259	0.267	0.275	0.290	0.290	0.289	0.289	0.288	0.288	0.287	0.282	0.005	0.028
SOFR - Term Rate - 1-Month (CME Term SOFR)	0.473	0.509	0.522	0.540	0.571	0.580	0.624	0.646	0.669	0.688	0.582	0.106	0.216
US Treasury - 2-Year	2.39	2.37	2.47	2.46	2.61	2.60	2.68	2.72	2.63	2.54	2.55	(0.01)	0.15
US Treasury - 10-Year	2.72	2.70	2.83	2.85	2.93	2.85	2.90	2.90	2.81	2.77	2.83	(0.06)	0.05
US Treasury - 20-Year	2.99	2.97	3.09	3.12	3.19	3.08	3.12	3.14	3.06	3.03	3.08	(0.05)	0.04
2-Year / 10-year Treasury Yield Curve Spread (10-year Treasury minus 2-year Treasury)	0.33	0.33	0.36	0.39	0.32	0.25	0.22	0.18	0.18	0.23	0.28	(0.05)	(0.10)

Rates – The Volatility of Rate Hikes – and – How did the 10yr Treasury React to 2017's QT?





Interesting Reads that didn't make the Report:

- IMF, Will Inflation Remain High? 4/7/22
- Dallas Fed, Commodity Financing Markets Shaken by Russia Invasion; Monitoring for U.S. Financial Stress, 4/14/22