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- Rate Hikes – A shot across Inflation’s bow.
- Balance Sheet – QT starts in next month.
- Fed Tools – Move over Scarcity, time for Ample.

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Rate Hikes – Let the Front Loading Begin

- FOMC increases FFTR by 50bps (new FFTR 1.00%).
- Post Meeting Press Conference
 - Powell: “A 75bps increase is not something the committee is actively considering ... assuming that economic and financial conditions evolve in ways that are consistent with our expectations, there’s a broad sense on the committee that additional 50bp increases should be on the table for the next couple of meetings.”

	May 3-4	June 14-15	July 26-27	Sept 20-21	Nov 1-2	Dec 13-14
Rate Hike Forecast	50bp	50bp	50bp	25bp	25bp	?
Expected Fed Funds	1.00%	1.50%	2.00%	2.25%	2.50%	?

- March SEP’s neutral rate is 2.40%.
- Rate Hike Derailers
 - Negative GDP in Q2 2022 (2 quarters in a row).
 - An escalation in geopolitical tensions.
- Taylor Rule Calculation
 - The Taylor rule is a formula that can be used to predict or guide how central banks should alter interest rates due to changes in the economy.
 - According to the Taylor Rule (based on today’s inputs), the policy rate should be 3.69%.

	Real Interest Rate (R-star) ⁽¹⁾	Current Inflation (Core PCE)	GDP Output above Potential (Out) ⁽²⁾	Inflation Target (T)
Inputs	minus 291bps	5.20	0.80	2.00
Calc	R-star + Core PCE + 1/2 (Out) + 1/2 (T) = Taylor Rule’s Fed Funds			
	(-2.91 + 5.20) = 2.29 + (0.40) = 2.69 + (1.00) = 3.69%			
<small>(1) R-Star - St. Louis Fed 1-Year Real Interest Rate</small>				
<small>(2) Out - 12-month average of GDP (3.6%) minus Fed’s GDP forecast for YE22 (2.8%).</small>				

- March SEP’s Terminal Rate is 2.80% (by YE23).

Balance Sheet – What Goes Up, Must Come Down

- FOMC will begin QT starting June 1st.
 - For Treasury securities, the cap will initially be set at \$30 billion per month and after three months will increase to \$60 billion per month.
 - For agency debt and agency mortgage-backed securities, the cap will initially be set at \$17.5 billion per month and after three months will increase to \$35 billion per month.
- According to the Richmond Fed, “ample” reserves would be “something equivalent to 20% of GDP” or approximately \$4.9TN, which, based on the pace

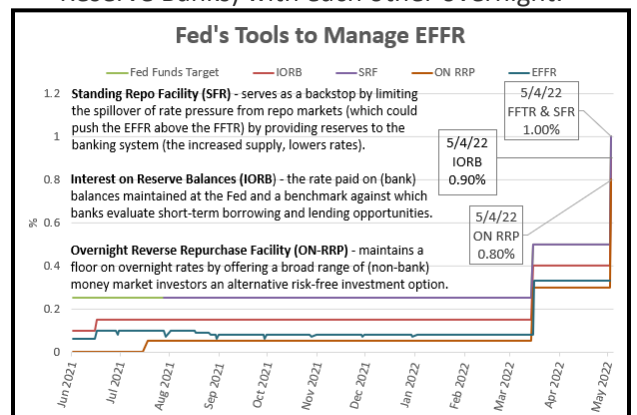
announced at today’s meeting, would likely be the level of the Fed’s Balance Sheet sometime in 2026.

Fed’s Tools – Scarcity of Reserves to Ample Reserves

- “For most of the Fed’s history, monetary policy operated in an environment of “scarce” reserves. Banks and other depository institutions tried to keep their reserves close to the bare minimum needed to meet reserve requirements.”
- “If a bank was at risk of falling short on reserves, it would borrow reserves overnight from other banks ... the interest rate on these short-term loans is the federal funds rate. Stable demand for reserves allowed the Fed to predictably influence the federal funds rate—the price of reserves—by changing the supply of reserves *thru* open market operations.”
- “As a result of the Fed’s efforts to stimulate the economy following the 2007–2008 financial crisis, the supply of reserves in the banking system grew very large. The amount is so large that most banks have many more reserves than they need to meet reserve requirements. In an environment with a superabundance of reserves, traditional open market operations that change the supply of reserves are no longer sufficient for adjusting the level of the federal funds rate.”

Source: St. Louis Fed, A New Frontier: Monetary Policy with Ample Reserves, May 2019

- As a result, 3 tools were created to help the Fed manage EFR: (1) IORB; (2) ON-RRP; (3) SRF.
- EFR (0.33%, 5/3/22) is the rate at which banks trade federal funds (balances held at Federal Reserve Banks) with each other overnight.



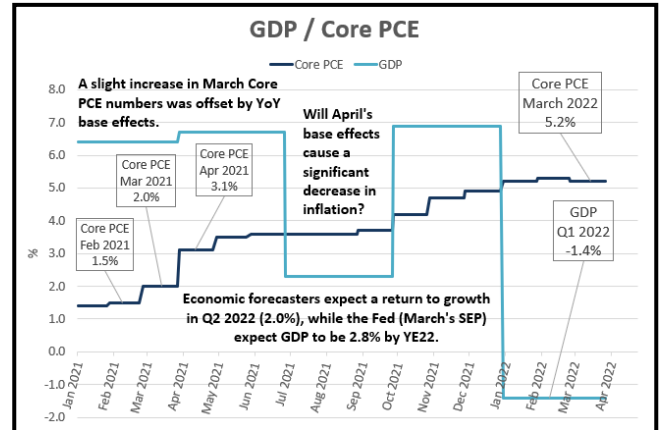
Quote of the Week
“The world exists for the education of each man.”
--- Ralph Waldo Emerson

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Economic Indicators:

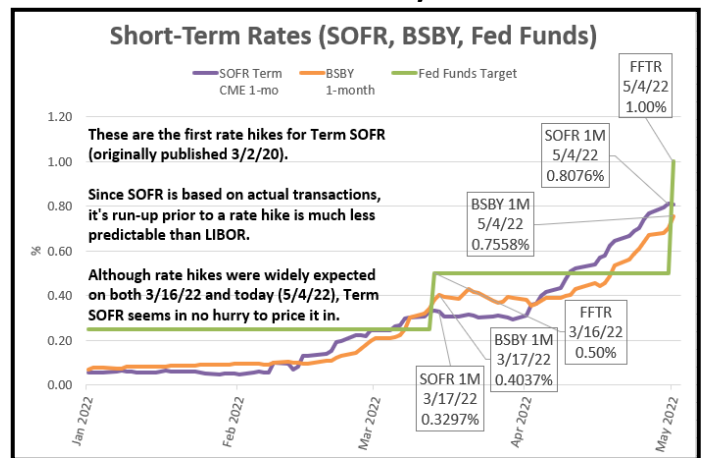
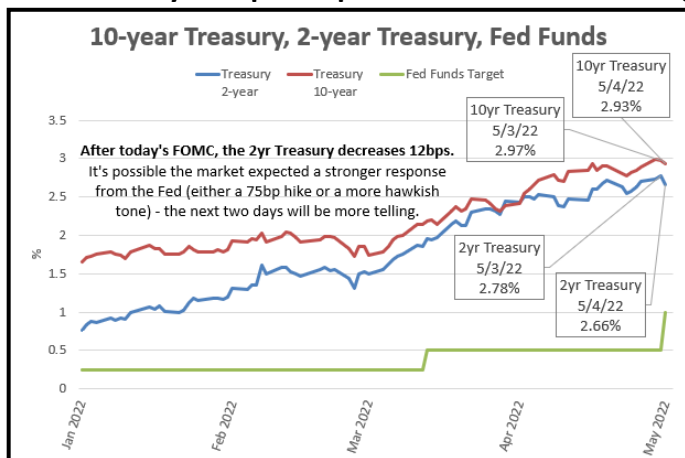
- Unemployment: 3.6% Mar (Fed's Long Run Rate: 4.0%)
 - Apr's unemployment #'s to be released Friday.
 - Median consensus is job growth of 400,000.
 - This would be a continued lower trend – March posted job growth of 431,000 – the 6-months prior (Sept to Feb) job growth averaged 598,333.
- Core PCE: 5.2% Mar (Fed's Avg. Inflation Target: 2.0%)
 - Dallas Fed's Trimmed Mean for Feb: 3.70%
 - Trims off the lower & upper data spikes.
 - St Lou Fed 5yr Breakeven Inflation Rate: 3.24%
 - Yield on Treasury minus yield on TIPS.
 - April's Core PCE will be released 5/27/22.
- GDP: -1.4% Q4 (Adv Est.) (Fed's Longer Run Rate 1.8%)
 - Q1 GDP (2nd Estimate) to be released 5/26/22.



Rates --- 10-Day Trends --- This week we've added: (1) Fed's Tools; (2) Bal. Sheet Info; (3) 3m/10yr YC spread

Key Interest Rates	4/20/22	4/21/22	4/22/22	4/25/22	4/26/22	4/27/22	4/28/22	4/29/22	5/2/22	5/3/22	5/4/22	10-Day Average	10-Day Avg vs 5/4/22	10-Day Change
Fed Funds Target Rate (FFTR)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00	0.55	↑ 0.45	↑ 0.50
Standing Repo Facility (SRF)	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00	0.55	↑ 0.45	↑ 0.50
Interest on Reserve Balances (IORB)	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.90	0.45	↑ 0.45	↑ 0.50
Effective Fed Funds Rate (EFFR)	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.33	0.00	0.33	0.00	0.00
Overnight Reverse Repo Facility (ON RRP)	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.80	0.35	↑ 0.45	↑ 0.50
Fed's Balance Sheet (Total Assets in Millions)	8,965,487	8,965,487	8,965,487	8,955,851	8,955,851	8,955,851	8,955,851	8,939,199	8,939,199	8,939,199	8,939,199	8,952,424	↑ 13,225	↓ (26,288)
BSBY - Overnight	0.325	0.329	0.330	0.331	0.331	0.329	0.330	0.330	0.325	0.321	0.316	0.327	↓ (0.011)	↓ (0.013)
BSBY - 1-month	0.458	0.486	0.534	0.560	0.589	0.609	0.642	0.673	0.682	0.704	0.756	0.623	↑ 0.132	↑ 0.270
SOFR - Overnight	0.270	0.260	0.270	0.270	0.270	0.280	0.280	0.280	0.300	0.300	0.000	0.278	↑ 0.022	↑ 0.030
SOFR - 30-Day Average	0.289	0.289	0.288	0.288	0.287	0.287	0.287	0.287	0.286	0.286	0.286	0.287	↓ (0.001)	↓ (0.002)
SOFR - Term Rate - 1-Month (CME Term SOFR)	0.580	0.624	0.646	0.669	0.688	0.700	0.742	0.766	0.795	0.811	0.808	0.725	↑ 0.083	↑ 0.184
US Treasury - 3-Month	0.82	0.83	0.83	0.91	0.83	0.82	0.82	0.85	0.90	0.91	0.89	0.86	↑ 0.03	↑ 0.06
US Treasury - 2-Year	2.60	2.68	2.72	2.63	2.54	2.58	2.63	2.70	2.73	2.78	2.66	2.67	0.00	↓ (0.02)
US Treasury - 10-Year	2.85	2.90	2.90	2.81	2.77	2.82	2.85	2.89	2.99	2.97	2.93	2.88	↑ 0.05	↑ 0.03
US Treasury - 20-Year	3.08	3.12	3.14	3.06	3.03	3.08	3.10	3.14	3.26	3.21	3.21	3.14	↑ 0.07	↑ 0.09
3-Month / 10-year Treasury Yield Curve Spread (10yr minus 3mo Treasury) (30yr historical avg: 1.68)	2.03	2.07	2.07	1.90	1.94	2.00	2.03	2.04	2.09	2.06	2.04	2.02	↑ 0.02	↓ (0.03)
2-Year / 10-year Treasury Yield Curve Spread (10yr minus 2yr Treasury) (30yr historical avg: 1.14)	0.25	0.22	0.18	0.18	0.23	0.24	0.22	0.19	0.26	0.19	0.27	0.22	↑ 0.05	↑ 0.05

Rates – The 2yr Drops 12bps after the FOMC Meeting – and – Term SOFR is in No Hurry



Interesting Reads that didn't make the Report:

- There weren't a lot of Fed speeches/reports to read due to the Fed's Blackout Period (April 23 – May 5).

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