Fed Unfiltered

6/22/22

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Waller – Lessons Learned for the Next Recession

- Rate Hikes: "This week, the Federal Open Market Committee (FOMC) took another significant step toward achieving our inflation objective by raising the Federal Funds rate target by 75 basis points. In my view, and I speak only for myself, if the data comes in as I expect I will support a similar-sized move at our July meeting."
- Lessons Learned: "I hope we never have another two years like 2020 & 2021, but because of the low-interest-rate environment we now face, I believe that even in a typical recession there is a decent chance that we will be considering policy decisions in the future similar to those we made over the past two years. Because of that likelihood, it is especially useful to consider the lessons learned."
- "Perhaps the most straightforward takeaway for monetary policy is that in times of severe stress, lending facilities, along with sharp cuts to the federal funds rate and the introduction of large-scale asset purchases, are very effective in reviving the economy."
- "Looking back, should the Committee have signaled a steeper rate path once the liftoff criteria had been met? Perhaps another lesson is that giving forward guidance about liftoff should also include forward guidance about the possible path of the policy rate after liftoff."

Source: Fed Board, Christopher Waller, Speech: Lessons Learned on Normalizing Monetary Policy, 6/18/22

Barkin – What a Return to Normal Means

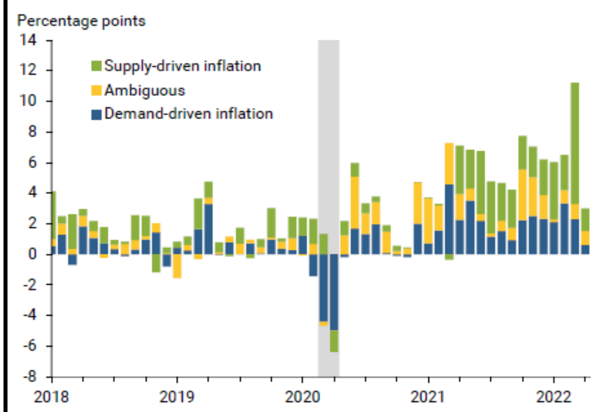
- "So, data on today's economy still looks relatively healthy. Tomorrow is of course unclear. Our path forward depends on three significant uncertainties. First, how long will it take the pandemic's impact on spending, labor supply and supply chains to normalize? Second, how high does the Fed need to raise rates to calm demand, bring inflation down and keep inflation expectations anchored? And third, what other outside forces will push demand and/or inflation up or down?"
- "We are out of balance today because stimulus-supported excess demand overwhelmed supply constrained by the pandemic and global commodity shocks. Returning to normal means products on shelves, restaurants fully staffed and cars at auto dealers. It doesn't have to require a calamitous decline in activity. As for financial markets, they are hardly the whole economy, but even they could benefit from reaffirmation that trees don't grow to the sky and a reminder that valuations are always worth a fresh look."

Source: Richmond Fed, Tom Barkin, Essay: The Recession Question, 6/21/22

Inflation – The Factors We Don't Control

- "The extent to which either supply or demand factors are responsible for higher inflation levels has important implications for monetary policy. As Fed Chair Powell stated in a recent interview, "What [the Fed] can control is demand, we can't really affect supply with our policies…so the question whether we can execute a soft landing or not, it may actually depend on factors that we don't control" (Marketplace 2022)."
- "Analysis in this *Letter* shows that supply factors are responsible for more than half of the current elevated level of 12-month PCE inflation. This in part reflects supply constraints from continued labor shortages and global supply disruptions related to the pandemic and the war in Ukraine. While demand factors played a large role in the spring of 2021, they explain only about a third of recent elevated inflation levels. Factors that cannot be labeled as either demand or supply are also playing a nontrivial role."

Figure 3
Contributions to annualized monthly changes in inflation



Note: Gray shading indicates NBER recession dates.

Source: SF Fed, Report: How Much Do Supply and Demand Drive Inflation? 6/21/22

Quote of the Week
"All things are difficult before they are easy."
--- Thomas Fuller

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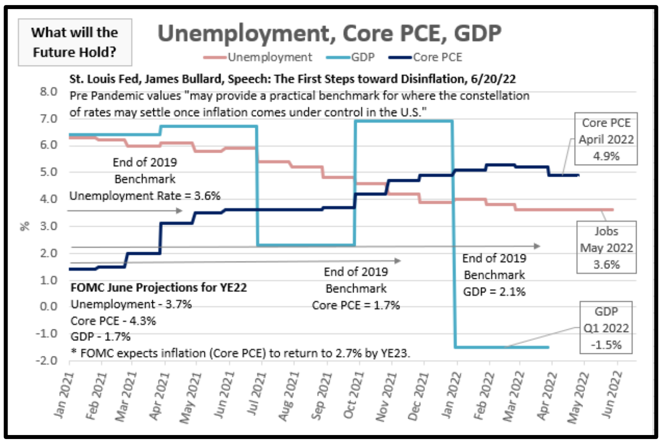
Economic Indicators:

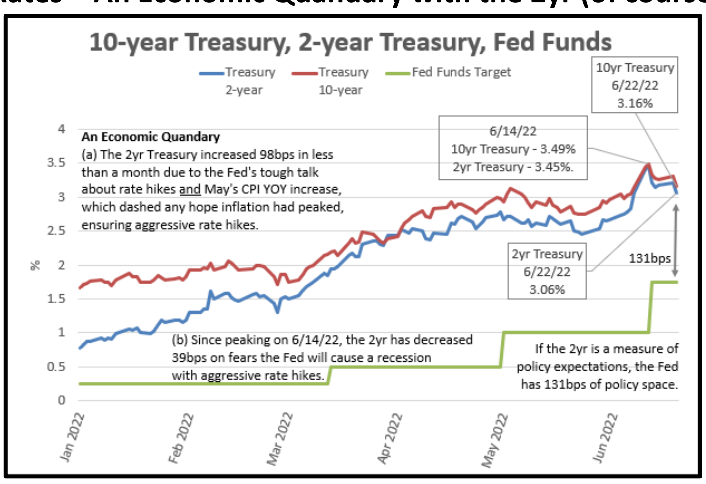
- GDP: -1.5% Q1 (2nd Est.) (Fed's Longer Run Rate 1.8%)
  - Q1 GDP (3rd Estimate) to be released 6/29/22.
  - Currently, median forecasts for Q2 GDP is +2.7%.
- Core PCE: 4.9% Apr (Fed's **Avg**. Inflation Target: 2.0%)
  - Dallas Fed's Trimmed Mean for Apr: 3.75%.
    - Trims off the lower & upper data spikes.
  - St Lou Fed 5yr Breakeven Inflation Rate: 2.74%.
    - Yield on Treasury minus yield on TIPS.
  - May's Core PCE will be released 6/30/22.
  - May's Core PCE forecasts are for a slight decline.
- Unemployment: 3.6% May (Fed's Long Run Rate: 4.0%)
  - May's unemployment #'s to be released 7/8/22.
  - Unemployment expected to increase thru YE22.

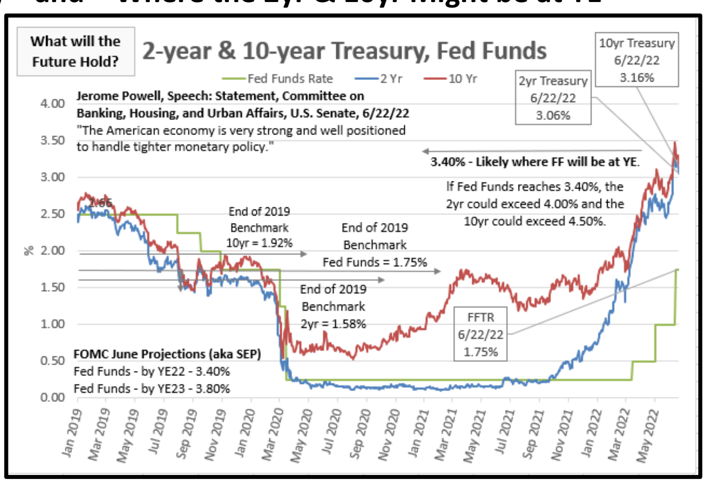


Rates --- 10-Day Trends

Key Interest Rates	6/7/22	6/8/22	6/9/22	6/10/22	6/13/22	6/14/22	6/15/22	6/16/22	6/17/22	6/21/22	6/22/22	10-Day Average	10-Day Avg vs 6/22/22	10-Day Change
Fed Funds Target Rate (FFTR)	1.00	1.00	1.00	1.00	1.00	1.00	1.75	1.75	1.75	1.75	1.75	1.38	0.38	0.75
Standing Repo Facility (SRF)	1.00	1.00	1.00	1.00	1.00	1.00	1.75	1.75	1.75	1.75	1.75	1.38	0.38	0.75
Interest on Reserve Balances (IORB)	0.90	0.90	0.90	0.90	0.90	0.90	0.90	1.65	1.65	1.65	1.65	1.20	0.45	0.75
Effective Fed Funds Rate (EFFR)	0.83	0.83	0.83	0.83	0.83	0.83	0.83	1.58	1.58	1.58	0.00	1.06	0.53	0.75
Overnight Reverse Repo Facility (ON RRP)	0.80	0.80	0.80	0.80	0.80	0.80	1.55	1.55	1.55	1.55	1.55	1.18	0.38	0.75
Fed's Balance Sheet (Total Assets in Millions)	8,915,050	8,915,050	8,918,254	8,918,254	8,918,254	8,918,254	8,932,420	8,932,420	8,932,420	8,932,420	8,932,420	8,924,111	(8,309)	17,370
BSBY - Overnight	0.821	0.824	0.824	0.823	0.835	0.825	0.829	0.829	0.992	1.554	1.579	0.991	0.588	0.755
BSBY - 1-month	1.015	1.075	1.127	1.188	1.202	1.214	1.260	1.328	1.489	1.572	1.598	1.305	0.293	0.523
SOFR - Overnight	0.770	0.760	0.750	0.750	0.730	0.690	0.700	1.450	1.450	1.450	0.000	0.950	0.500	0.680
SOFR - 30-Day Average	0.785	0.785	0.784	0.783	0.779	0.777	0.774	0.771	0.792	0.881	0.903	0.803	0.100	0.119
SOFR - Term Rate - 1-Month (CME Term SOFR)	1.184	1.199	1.244	1.258	1.279	1.334	1.477	1.509	1.507	1.499	1.505	1.381	0.124	0.306
US Treasury - 3-Month	1.26	1.28	1.30	1.39	1.73	1.83	1.74	1.59	1.63	1.70	1.61	1.58	0.03	0.33
US Treasury - 2-Year	2.75	2.78	2.83	3.06	3.40	3.45	3.20	3.14	3.17	3.21	3.06	3.13	(0.07)	0.28
US Treasury - 10-Year	2.98	3.03	3.04	3.15	3.43	3.49	3.33	3.28	3.25	3.31	3.16	3.25	(0.09)	0.13
US Treasury - 20-Year	2.35	3.40	3.40	3.45	3.68	3.72	3.64	3.59	3.55	3.63	3.49	3.56	(0.07)	0.09
3-Month / 10-year Treasury Yield Curve Spread (10yr minus 3mo Treasury) **(30yr historical avg: 1.68)**	1.72	1.75	1.74	1.76	1.70	1.66	1.59	1.69	1.62	1.61	1.55	1.67	(0.12)	(0.20)
2-Year / 10-year Treasury Yield Curve Spread (10yr minus 2yr Treasury) **(30yr historical avg: 1.14)**	0.23	0.25	0.21	0.09	0.03	0.04	0.13	0.14	0.08	0.10	0.10	0.12	(0.02)	(0.15)

Rates – An Economic Quandary with the 2yr (of course) – and – Where the 2yr & 10yr Might be at YE





Interesting Reads that didn't make the Report:

- St. Louis Fed, James Bullard, Speech: The First Steps toward Disinflation, 6/20/22
- Dallas Fed, Report: High Fuel Prices in the U.S. May Crimp Oil Demand Soon, 6/21/22
- St. Louis Fed, Report: Is the Labor Market as Tight as It Seems? 6/21/22