# Fed Unfiltered

**WEEKLY REPORT** 9/12/22

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**FOMC – The General Consensus**

- High inflation needs to be addressed.
- To do so, the policy rate needs to go into restrictive territory, possibly between 3.75%-4.25% (currently Fed Funds is at neutral, 2.50%).
- This "restrictive stance" could be held in place for a year (through 2023) or, at the least until a peak in inflation has been identified and there are several months of declining readings (Mester).
- Rate cuts are unlikely in 2023 due to the Fed's universal worry about declaring victory on inflation too soon, as was mistakenly done in the 1970s.
- Although a rate hike in Sept is a foregone conclusion, this meeting could be the beginning of a disagreement between FOMC members, w/ some members worried about the lag of monetary policy and the risk of "overtightening" while others prefer front loading & "significant increases" (see below).

**FOMC – The Potential for Disagreement Begins**

- Brainard: "At some point in the tightening cycle, the risks will become more two-sided. The rapidity of the tightening cycle and its global nature, as well as the uncertainty around the pace at which the effects of tighter financial conditions are working their way through aggregate demand, create risks associated with overtightening."
- George: "We will have to determine the course of our policy through observation rather than reference to theoretical models or pre-pandemic trends. Given the likely lags in the passthrough of tighter monetary policy to real economic conditions, this argues for steadiness and purposefulness over speed."
- Bullard: "So, I am leaning more strongly toward 75 at this point … 'The general strategy of trying to front-load these rate increases is working well and putting us in a position where we can have a level of the policy rate that is putting downward pressure on inflation very soon … And sooner tends to be better in my mind."

Source: Lael Brainard, Speech: Bringing Inflation Down, 9/7/22; Esther George, Speech: Constraints on the Economy and Policy, 9/9/22; James Bullard, Interview: Bloomberg Print, 9/9/22

**Taylor Rule – Ubiquitous in All the Work of the Fed**

- "So more broadly on rules. Of course, Taylor rules have become part of the fabric of economic analysis, particularly monetary policy analysis in ways that must be far greater than John Taylor could have hoped when he wrote his original article in 1993. But we know central bank and the Fed has never explicitly tied our monetary policy decisions to any formula, including Taylor rules, but Taylor rules, nonetheless, are ubiquitous in all of the work that we do."

| | Real Interest Rate (R-star)(1) | Current Inflation (Core PCE) | GDP Output above Potential (Out) (2) | Inflation Target (T) |
|---|---|---|---|---|
| **Inputs** | minus 144bps | 4.60 | 0.30 | 2.00 |
| **Calc** | R-star + Core PCE + 1/2 (Out) + 1/2 (T) = Taylor Rule's Fed Funds | | | |
| | (-1.45 + 4.60) = **3.15** + (0.15) = **3.30** + (1.00) = **4.30%** | | | |
| (1) R-Star - St. Louis Fed 1-Year Real Interest Rate | | | | |
| (2) Out - 12-month average of GDP (2.0%) minus Fed's June SEP GDP forecast for YE22 (1.7%). | | | | |

Quote Source: Jerome Powell, Interview: Cato Institute Monetary Conference, 9/8/22; Table, Source: Fed Unfiltered's Pete Sullivan.

**QT – In Sept, Runoff Increases to $95BN (from $47.5BN)**

- "The following chart shows projections of future maturities of Treasury securities held by the Fed along with the monthly cap … Proceeds from maturing Treasury securities (light blue and light red bars) in excess of the cap will continue to be reinvested into new securities at U.S. Treasury auctions."

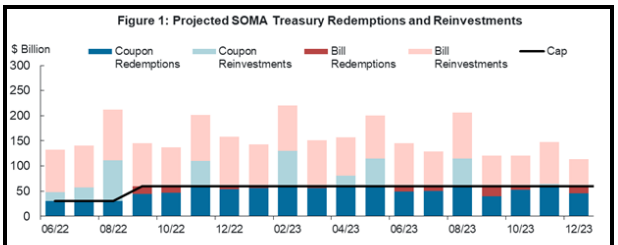


Figure 1: Projected SOMA Treasury Redemptions and Reinvestments

Note: The light red bars exceed the maturities of current Treasury bill holdings because the projection assumes that Treasury bills are reinvested several times over the period covered by the chart.
Source: Federal Reserve Bank of New York

- "The pace of the Fed's agency MBS runoff going forward is subject to significant uncertainty. Prepayments of mortgages are likely to continue to be driven primarily by the personal motivations of mortgage holders, such as whether to move to a new home, rather than by the ability to refinance at a lower interest rate. New York Fed staff projections indicate that agency MBS monthly principal payments could range between $20 and $30 billion over the next several months, and so would likely not exceed the higher monthly cap that starts this month. In this case, the Fed would cease reinvestments and the reduction of SOMA agency MBS holdings would be less than the $35BN cap."

Source: NY Fed, Report: The "How and When" of the Fed's Balance Sheet Runoff, 9/8/22

**"Quote of the Week**
"I have been impressed with the urgency of doing. Knowing is not enough; we must apply. Being willing is not enough; we must do.
--- Leonardo da Vinci

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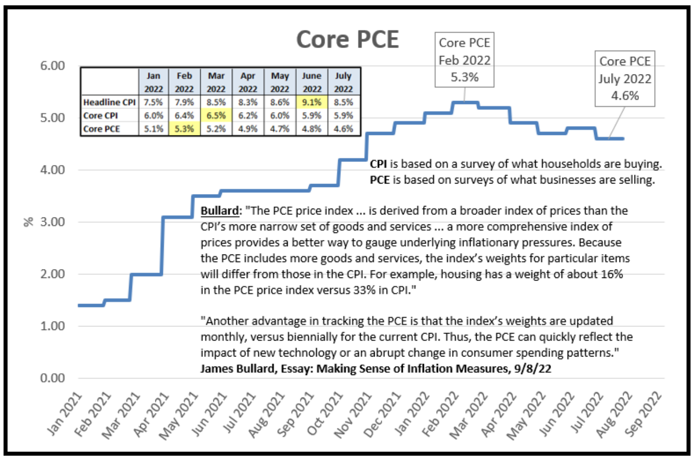
**Economic Indicators:**

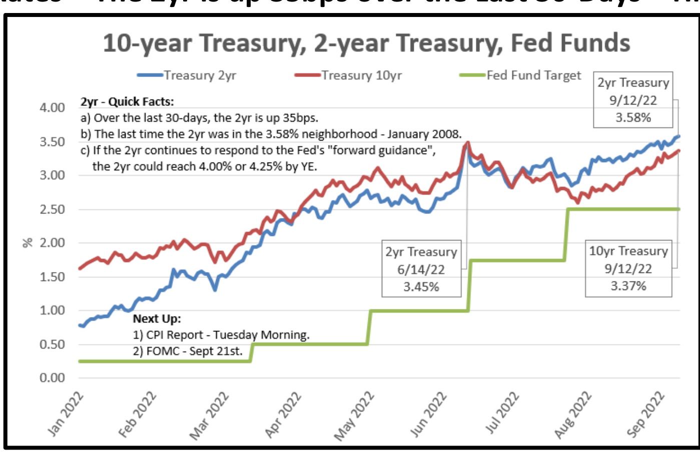
- GDP: -0.6% Q2 (2nd Est.) (Fed's Longer Run Rate 1.8%)
  - Q2 GDP (3rd Estimate) to be released 9/29/22.
  - Q3 GDPNow estimate is +1.3% (posted 9/9/22).
- Core PCE: 4.6% July (Fed's Avg. Inflation Target: 2.0%)
  - Another great article about CPI/PCE: Cleveland Fed, PCE and CPI Inflation: What's the Difference? 4/17/14.
  - Dallas Fed's Trimmed Mean for July: 4.40%.
    - Trims off the lower & upper data spikes.
  - St Lou Fed 5yr Breakeven Inflation Rate: 2.52%.
    - Yield on Treasury minus yield on TIPS.
  - August's Core PCE will be released 9/30/22.
- Unemployment: 3.7% Aug (Fed's Long Run Rate: 4.0%)
  - Sept's unemployment #'s will be out 10/7/22.

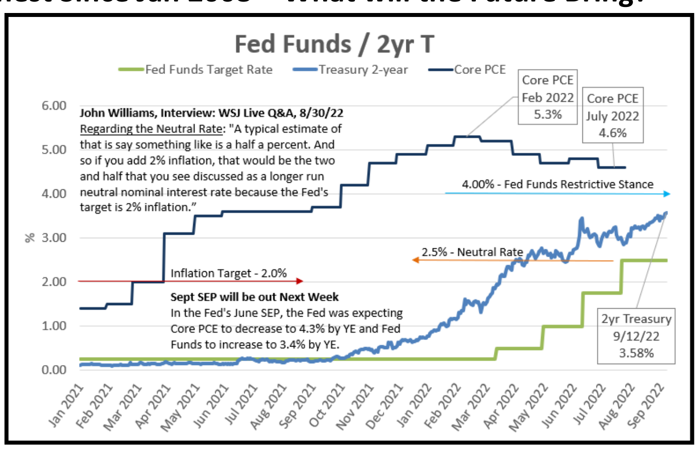



## Rates --- 2-Week Trends

| Key Interest Rates | 8/26/22 | 8/29/22 | 8/30/22 | 8/31/22 | 9/1/22 | 9/2/22 | 9/6/22 | 9/7/22 | 9/8/22 | 9/9/22 | 9/12/22 | 10-Day Average | 10-Day Avg vs 9/12/22 | 10-Day Change |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fed Funds Target Rate (FFTR) | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 0.00 | 0.00 |
| Standing Repo Facility (SRF) | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 0.00 | 0.00 |
| Interest on Reserve Balances (IORB) | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 2.40 | 0.00 | 0.00 |
| Effective Fed Funds Rate (EFFR) | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 2.33 | 0.00 | 2.33 | 0.00 | 0.00 |
| Overnight Reverse Repo Facility (ON RRP) | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 2.30 | 0.00 | 0.00 |
| Fed's Balance Sheet (Total Assets in Millions) | 8,851,436 | 8,851,436 | 8,851,436 | 8,826,093 | 8,826,093 | 8,826,093 | 8,826,093 | 8,822,401 | 8,822,401 | 8,822,401 | 8,822,401 | 8,831,662 | 9,261 | 29,035 |
| BSBY - Overnight | 2.339 | 2.341 | 2.336 | 2.337 | 2.340 | 2.341 | 2.341 | 2.345 | 2.348 | 2.346 | 2.345 | 2.342 | 0.003 | 0.003 |
| BSBY - 1-month | 2.396 | 2.406 | 2.403 | 2.433 | 2.451 | 2.504 | 2.518 | 2.543 | 2.576 | 2.644 | 2.655 | 2.513 | 0.141 | 0.249 |
| SOFR - Overnight | 2.280 | 2.280 | 2.290 | 2.290 | 2.290 | 2.290 | 2.290 | 2.280 | 2.280 | 2.280 | 0.000 | 2.285 | (0.005) | 0.000 |
| SOFR - 30-Day Average | 2.258 | 2.283 | 2.284 | 2.284 | 2.285 | 2.284 | 2.285 | 2.285 | 2.285 | 2.285 | 2.285 | 2.285 | 0.000 | 0.002 |
| SOFR - Term Rate - 1-Month (CME Term SOFR) | 2.459 | 2.455 | 2.512 | 2.522 | 2.595 | 2.624 | 2.654 | 2.683 | 2.748 | 2.779 | 2.806 | 2.638 | 0.168 | 0.351 |
| US Treasury - 3-Month | 2.89 | 2.97 | 2.97 | 2.96 | 2.97 | 2.94 | 3.04 | 3.07 | 3.06 | 3.08 | 3.17 | 3.02 | 0.15 | 0.20 |
| US Treasury - 2-Year | 3.37 | 3.42 | 3.46 | 3.45 | 3.51 | 3.40 | 3.50 | 3.45 | 3.48 | 3.56 | 3.58 | 3.48 | 0.10 | 0.16 |
| US Treasury - 10-Year | 3.04 | 3.12 | 3.11 | 3.15 | 3.26 | 3.20 | 3.33 | 3.27 | 3.29 | 3.33 | 3.37 | 3.24 | 0.13 | 0.25 |
| US Treasury - 20-Year | 3.44 | 3.50 | 3.49 | 3.53 | 3.64 | 3.61 | 3.74 | 3.67 | 3.69 | 3.71 | 3.76 | 3.63 | 0.13 | 0.26 |
| 3-Month / 10-year Treasury Yield Curve Spread (10yr minus 3mo Treasury) **(30yr historical avg: 1.68)** | 0.15 | 0.15 | 0.14 | 0.19 | 0.29 | 0.26 | 0.29 | 0.20 | 0.23 | 0.25 | 0.20 | 0.22 | (0.02) | 0.05 |
| 2-Year / 10-year Treasury Yield Curve Spread (10yr minus 2yr Treasury) **(30yr historical avg: 1.14)** | (0.33) | (0.30) | (0.35) | (0.30) | (0.25) | (0.20) | (0.17) | (0.18) | (0.19) | (0.23) | (0.21) | (0.24) | 0.03 | 0.09 |

## Rates – The 2yr is up 35bps over the Last 30-Days – Highest Since Jan 2008 – What will the Future Bring?




**Interesting Reads that didn't make the Report:**

- St. Louis Fed: Demand-Supply imbalance during the COVID-19 pandemic, The role of fiscal policy, 9/2/22
- James Bullard, Essay: Making Sense of Inflation Measures, 9/8/22
- Christopher Waller, Speech: The Economic Outlook: Time to Let the Data Do the Talking, 9/9/22