Fed Unfiltered

WEEKLY REPORT **9/21/22**

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FOMC – Three Times is a Charm – A 75bp Rate Hike

- "Over coming months, we'll be looking for compelling evidence that inflation is moving down … we anticipate that ongoing increases in the target range for the Federal Funds rate will be appropriate … at some point as the stance of monetary policy tightens further, it will become appropriate to slow the pace of increases, while we assess how our accumulative policy adjustments are affecting the economy and inflation."
  Source: Jerome Powell, Post FOMC Press Conference, 9/21/22

FOMC –The 90-Day Forecast

- Growth will slow significantly, unemployment will be up slightly, Core PCE to fall slightly and FF is headed higher, possibly by another 125bps.

	Summary of Economic Projections --- Released 9/21/22		Currently
GDP	June SEP Forecast --- for YE 2022	1.7%	
	Sept SEP Forecast --- for YE 2022	0.2%	-0.6%
Unemployment	June SEP Forecast --- for YE 2022	3.7%	
	Sept SEP Forecast --- for YE 2022	3.8%	3.7%
Core PCE	June SEP Forecast --- for YE 2022	4.3%	
	Sept SEP Forecast --- for YE 2022	4.5%	4.6%
Fed Funds	June SEP Forecast --- for YE 2022	3.4%	
	Sept SEP Forecast --- for YE 2022	4.4%	3.25%

FOMC – The Benefit of Transparency

- Through clear communication about future rates (aka forward guidance), the Fed has methodically nudged rates higher the first 9-months of 2022.
  - The 2yr has increased 324bps since January.
  - Fed Funds have increased 300bps.
  - Over a similar time period in 1994 (Jan to Nov) FF increased 225bps; 2yr increased by 280bps.
- Primarily done through speeches and interviews.
  - 2022: Board has given 50 speeches/interviews.
  - Presidents have given 91 speeches/interviews.
- Recently though, several Fed officials have mentioned forward guidance will be less clear than it has been – possibly due to lack of clear consensus.

QT – Likely a Question on the FOMC's Mind

- "Despite plans announced last May to significantly reduce the size of the balance sheet, the potential exists that there is an asymmetry that allows for relatively easy increases in the balance sheet but makes subsequent decreases more difficult. In a paper presented at this year's Jackson Hole Symposium, the authors argue that financial markets can become dependent on the increased liquidity added to the system as the balance sheet expands. After markets have adapted and allocated the massive increase in liquidity from asset purchases, subsequently reducing the balance sheet can be difficult. As a result, large reductions in liquidity, especially absent a signal on longer-run objectives for the balance sheet, can result in volatility, like we witnessed in September 2019.
  Source: Esther George, Speech: Constraints on the Economy and Policy, 9/9/22

QT – Into the Great Unknown

- "There is still debate among economists over how and how well it (QE) works. And when it comes to the reverse process of shrinking the Fed's balance sheet, typically referred to as quantitative tightening (QT), economists know even less … The Fed has only attempted QT once before — from October 2017 to September 2019. This makes estimates even more uncertain, as Powell alluded to in his May press conference."
  Source: Richmond Fed, Report: The Fed Is Shrinking Its Balance Sheet, What Does That Mean? 9/6/22

QT – Will the Fall of 2019's Instability be Repeated?

- "When the Federal Reserve conducts QT, it reduces the supply of bank reserves, which are an important liquid asset for banks. Federal Reserve balance sheet policy (that is, whether the Federal Reserve is expanding or reducing its balance sheet through QE or QT) sets the supply of reserves, whereas financial markets determine the demand for them. However, that demand can be difficult to observe and predict ... In the fall of 2019, for example, interest rates in private repo markets rapidly increased, a sign of stress that suggested a sudden unmet need for liquidity in financial markets. That spike occurred at a time when the Federal Reserve was using QT to remove some of the accommodation its earlier expansion in response to the 2007–2009 recession had provided. The central bank announced the precise and very gradual reduction in the level of reserves well in advance, but a shortage of liquid assets emerged suddenly and led to uncertainty in broader financial markets. Another QT program would pose similar risks of instability in financial markets … Those risks are mitigated somewhat by the Federal Reserve's introduction of a standing repo facility *(established July 2021),* which allows primary dealers and select depository institutions to convert Treasury securities and agency MBSs into reserves when necessary."
  Source: CBO, Report: How the Federal Reserve's Quantitative Easing Affects the Federal Budget, 9/8/22

"**Quote of the Week**
"Life is really simple, but we insist on making it complicated." --- Confucius

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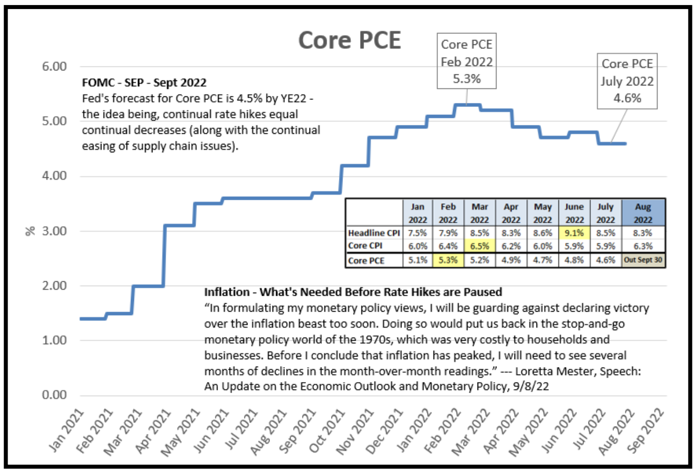
Economic Indicators:

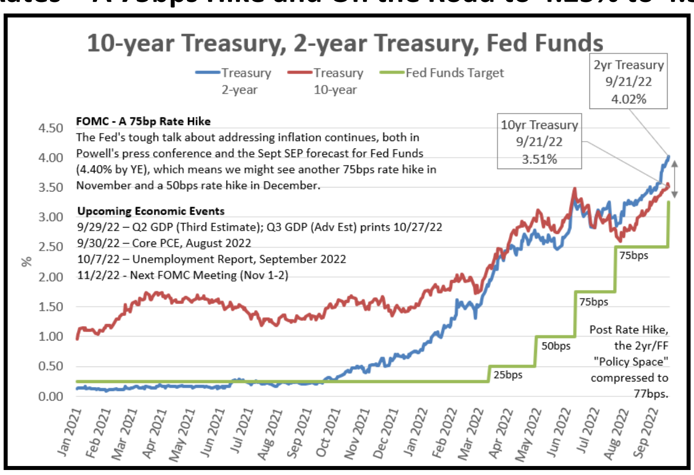
- GDP: -0.6% Q2 (2nd Est.) (Fed's Longer Run Rate 1.8%)
  - Q2 GDP (3rd Estimate) to be released 9/29/22.
  - Q3 GDPNow estimate is +0.3% (posted 9/20/22).
  - GDPNow estimate for Q2 (-1.6%) turned out to be 0.7% lower than Q2's actual GDP (-0.9%).
  - Q3 GDP Adv Estimate will be released 10/27/22.
- Core PCE: 4.6% July (Fed's Avg. Inflation Target: 2.0%)
  - Dallas Fed's Trimmed Mean for July: 4.40%.
    - Trims off the lower & upper data spikes.
  - St Lou Fed 5yr Breakeven Inflation Rate: 2.47%.
    - 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.

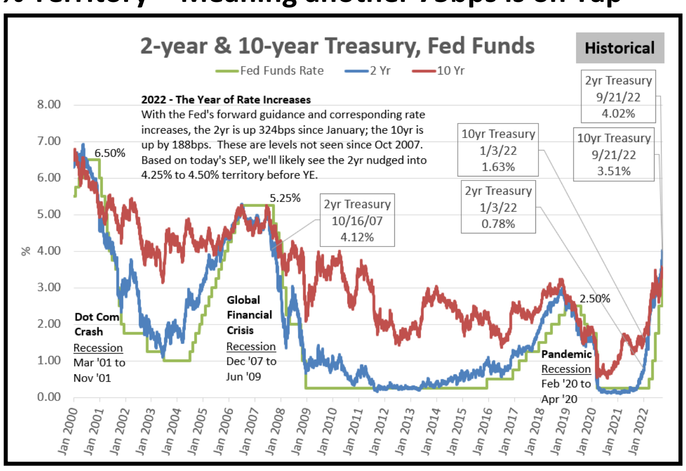


Rates --- 2-Week Trends

Key Interest Rates	9/7/22	9/8/22	9/9/22	9/12/22	9/13/22	9/14/22	9/15/22	9/16/22	9/19/22	9/20/22	9/21/22	10-Day Average	10-Day Avg vs 9/21/22	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	3.25	2.58	0.68	0.75
Standing Repo Facility (SRF)	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	3.25	2.58	0.68	0.75
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	3.05	2.38	0.67	0.75
Fed's Balance Sheet (Total Assets in Millions)	8,822,401	8,822,401	8,822,401	8,822,401	8,822,401	8,832,759	8,832,759	8,832,759	8,832,759	8,832,759	8,832,759	8,828,051	(4,708)	10,358
BSBY - Overnight	2.345	2.348	2.346	2.345	2.345	2.347	2.345	2.342	2.344	2.340	2.344	2.345	0.000	(0.004)
BSBY - 1-month	2.543	2.576	2.644	2.655	2.673	2.719	2.770	2.856	2.893	2.918	2.983	2.769	0.214	0.407
SOFR - Overnight	2.280	2.280	2.280	2.280	2.280	2.270	2.280	2.270	2.270	2.260	0.000	2.275	(0.015)	(0.020)
SOFR - 30-Day Average	2.285	2.285	2.285	2.285	2.285	2.285	2.284	2.284	2.283	2.282	2.282	2.284	(0.002)	(0.004)
SOFR - Term Rate - 1-Month (CME Term SOFR)	2.683	2.748	2.779	2.806	2.845	2.922	3.018	3.024	3.047	3.076	3.075	2.934	0.141	0.328
US Treasury - 3-Month	3.07	3.06	3.08	3.17	3.28	3.24	3.22	3.20	3.37	3.35	3.31	3.23	0.08	0.25
US Treasury - 2-Year	3.45	3.48	3.56	3.58	3.75	3.78	3.87	3.85	3.95	3.96	4.02	3.78	0.24	0.54
US Treasury - 10-Year	3.27	3.29	3.33	3.37	3.42	3.41	3.45	3.45	3.49	3.57	3.51	3.43	0.08	0.22
US Treasury - 20-Year	3.67	3.69	3.71	3.76	3.75	3.73	3.75	3.79	3.77	3.83	3.73	3.75	(0.02)	0.04
3-Month / 10-year Treasury Yield Curve Spread (10yr minus 3mo Treasury) **(30yr historical avg: 1.68)**	0.20	0.23	0.25	0.20	0.14	0.17	0.23	0.25	0.12	0.22	0.20	0.20	0.00	(0.03)
2-Year / 10-year Treasury Yield Curve Spread (10yr minus 2yr Treasury) **(30yr historical avg: 1.14)**	(0.18)	(0.19)	(0.23)	(0.21)	(0.33)	(0.37)	(0.42)	(0.40)	(0.46)	(0.39)	(0.51)	(0.35)	(0.16)	(0.32)

Rates – A 75bps Hike and On the Road to 4.25% to 4.50% Territory – Meaning another 75bps is on Tap





Interesting Reads that didn't make the Report:

- NY Fed, Report: How Can Safe Asset Markets Be Fragile? 9/8/22
- Richmond Fed, Report: Anticipated FOMC Policy, Inflation and Credibility, 9/9/22
- IMF, Report: A New Era for Money, 9/13/22