Fed Unfiltered

WEEKLY REPORT 10/11/22

Pete Sullivan
Rate Analyst
206-502-3811
pete.sullivan@fedunfiltered.com

Overview

FOMC – 75bps Still Most Likely at Nov 1-2 FOMC

- Communication/forward guidance from the Fed remains steadfast – inflation is too high, we'll see between 100-125bps in hikes over the next two meetings (Nov 1-2, Dec 13-14) and no one wants to repeat the rate hike/rate cut approach of the 1970's, where rate cuts were implemented before inflation was fully addressed.
- 30-Day Window – 75bps Rate Hike.
  - Either a 50bps or 75bps rate hike in Nov – baring an economic event (similar to England's tax/budgeting financial stability moment), 75bps hike is most likely – front-loading rate hikes still comes up in speeches/interviews.
- 60-Day Window – 50bps Rate Hike.
  - We're likely to see another 50bps rate hike in Dec, although that's one GDP report, two Core PCE and two CPI reports away.
- 90-Day Window – Unknown.
  - Fed officials have talked about an additional rate hike in Q1 2023 – the Sept SEP has Fed Funds at 4.60% by YE23, which could mean another 25bps hike at the Jan 31-1 FOMC, although Dec's SEP will be more telling.

Rates – Rolling Five Days

- In the last week, rates were up across the board– the 2yr by 20bps; the 10yr by 31bps- the 3m/10yr YC had improved by 27bps, but today's as yet unexplained 22bps increase with the 3-month Treasury cut into that improvement.

Key Interest Rates	10/4/22	10/5/22	10/6/22	10/7/22	10/11/22	5-Day Change
Fed Funds Target Rate (FFTR)	3.25	3.25	3.25	3.25	3.25	0.00
BSBY - Overnight	3.107	3.101	3.097	3.099	3.102	(0.004)
BSBY - 1-month	3.110	3.143	3.147	3.154	3.162	0.052
SOFR - Overnight	3.040	3.040	3.050	3.050	0.000	0.010
SOFR - 30-Day Average	2.562	2.587	2.612	2.637	2.740	0.178
SOFR - Term Rate - 1-Month	3.108	3.126	3.268	3.274	3.289	0.181
US Treasury - 3-Month	3.45	3.46	3.46	3.45	3.67	0.22
US Treasury - 2-Year	4.10	4.15	4.23	4.30	4.30	0.20
US Treasury - 10-Year	3.62	3.76	3.83	3.89	3.93	0.31
US Treasury - 20-Year	3.95	4.05	4.08	4.13	4.19	0.24
YC Spread - 3-Month / 10-year Treasury	0.17	0.30	0.37	0.44	0.26	0.09
YC Spread - 2-Year / 10-year Treasury	(0.48)	(0.39)	(0.40)	(0.41)	(0.37)	0.11

Speeches and Interviews

Fed Officials – Interesting Comments from the Week

- Bostic: "To sum up the policy reversals, as the FOMC repeatedly shrank and then grew the money supply, the federal funds rate climbed from about 4 to over 9 percent in two years then dropped back to less than 4 percent over about a year-and-a-half, and then scaled up again to above 10 percent three years later, in the middle of 1974. The funds rate declined yet again to around 4 percent in late 1976 before beginning a steady climb and holding at over 8 percent … In hindsight, the Fed reacted too quickly to changes in the real economy, such as rising unemployment. Policy reversals never allowed inflation to fully recede to the 1 to 3 percent range for most of the 1980s."
  Raphael Bostic, Speech: Staying Purposeful and Resolute in the Battle against Inflation, 10/5/22

- Evans: "If you look at the median participant who submitted projections for where our federal funds rate will end at the end of this year, there are only two meetings, they're looking for 125 basis points of increase. So in two meetings, how do you do 125 basis points of increase? Well, you can sort make that choice yourself."
  Charles Evans, Interview: Illinois Chamber of Commerce Annual Luncheon, 10/6/22

- Waller: "Before the next meeting on November 1–2, there is not going to be a lot of new data to cause a big adjustment to how I see inflation, employment, and the rest of the economy holding up. We will get September payroll employment data tomorrow, and CPI and PCE inflation reports later this month. I don't think that this extent of data is likely to be sufficient to significantly alter my view of the economy, and I expect most policymakers will feel the same way. I imagine we will have a very thoughtful discussion about the pace of tightening at our next meeting."
- "I've read some speculation recently that financial stability concerns could possibly lead the FOMC to slow rate increases or halt them earlier than expected. Let me be clear that this is not something I'm considering or believe to be a very likely development … I am a little confused about this speculation. While there has been some increased volatility and liquidity strains in financial markets lately, overall, I believe markets are operating effectively. Actions by banks and financial regulators in recent years have greatly strengthened the financial system. Banks are well capitalized. Functioning in the Treasury, equity, and commodity markets remains orderly."
  Christopher Waller, Speech: The Economic Outlook with a Look at the Housing Market, 10/6/22

- Bullard: "A better way to think about it is that we've been through a war, George Hall of Yale University and Tom Sargent of NYU have a paper called Financing Three World Wars. And what they meant was World War I, World War II and the pandemic. I think it is like a war in the sense that the national crisis occurs, the government borrow a lot of money to pay for mitigating the crisis and the central bank accommodates that borrowing. But this all makes sense because you're in a national crisis as we were

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in especially in March and April of 2020 … But when the war's over, you switch back to the pre-war policy of less deficit spending and a monetary authority that concentrates on its inflation target. And that to me is exactly what's happening both on the fiscal side in US politics and also on the monetary side with the FOMC that you're switching back to the pre pandemic policy.

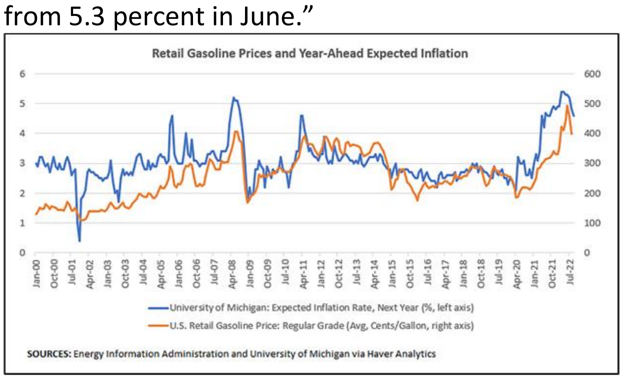
- "I think we do pay a lot of attention to inflation expectations and I in particular like the market based measures of inflation expectations that are derived from the TIPS market, also inflation swaps and other methods. I'm pleased that those have come back down under 3%, even under 2.5% for the five year forward. That's very encouraging from my point of view."

James Bullard, Interview: HSBC Global Emerging Markets Forum, 9/29/22

Reports

Inflation – Gas Prices & Expectations go Hand in Hand

- "Historically, declining gas prices have been correlated with improvements in consumer sentiment and expectations for the future. The Michigan consumer sentiment index improved from 50.0 in June to a preliminary reading of 59.5 in September."
- "Cheaper gas prices have also affected households' expectations for near-term inflation. As shown in Figure 1 below, households' year-ahead inflation expectations in the Michigan survey fell to 4.6 percent in September's preliminary survey reading from 5.3 percent in June."



Richmond Fed, Report: How Pump Prices Play With Monetary Policy, 10/4/22

Productivity – Gains with Computers Ended in 2005

- "Most of these productivity gains are concentrated in the 1985-2005 period, when computers and electronics were incorporated into virtually every industry. During this period, Moore's Law accounts for 14.22 percent of all productivity growth … after the mid-2000s, productivity contributions from Moore's Law become negligible and overall productivity declined. Before 1985, computers were still too large to make a significant contribution to the performance of most services and products. After 2005, computers had become so small that they had already become essential in almost every industry, and any subsequent adoption since then has only led to incremental improvements in productivity."

NY Fed, Report: Computer Saturation and the Productivity Slowdown, 10/6/22

Liquidity – The Open-Ended Fund Mismatch

- "Mutual funds that allow investors to buy or sell their shares daily are an important component of the financial system, offering investment opportunities to investors and providing financing to companies and governments."
- "These funds may invest in relatively liquid assets such as stocks and government bonds, or in less-frequently-traded securities like corporate bonds. Those with less-liquid holdings, however, have a major potential vulnerability. Investors can sell shares daily at a price set at the end of each trading session, but it may take fund managers several days to sell assets to meet these redemptions, especially when financial markets are volatile."
- "Such liquidity mismatch can be a big problem for fund managers during periods of outflows because the price paid to investors may not fully reflect all trading costs associated with the assets they sold. Instead, the remaining investors bear those costs, creating an incentive for redeeming shares before others do, which may lead to outflow pressures if market sentiment dims."
- "Pressures from these investor runs could force funds to sell assets quickly, which would further depress valuations. That in turn would amplify the impact of the initial shock and potentially undermine the stability of the financial system."
- "Now the resilience of the open-end fund sector may again be tested, this time amid rising interest rates and high economic uncertainty. Outflows from open-end bond funds have increased in recent months, and a sudden, adverse shock like a disorderly tightening of financial conditions could trigger further outflows and amplify stress in asset markets."

IMF, Report: How Illiquid Open-End Funds Can Amplify Shocks and Destabilize Asset Prices, 10/4/22

Quote of the Week

"The greatness of a man is not in how much wealth he acquires, but in his integrity and his ability to affect those around him positively."
--- Bob Marley

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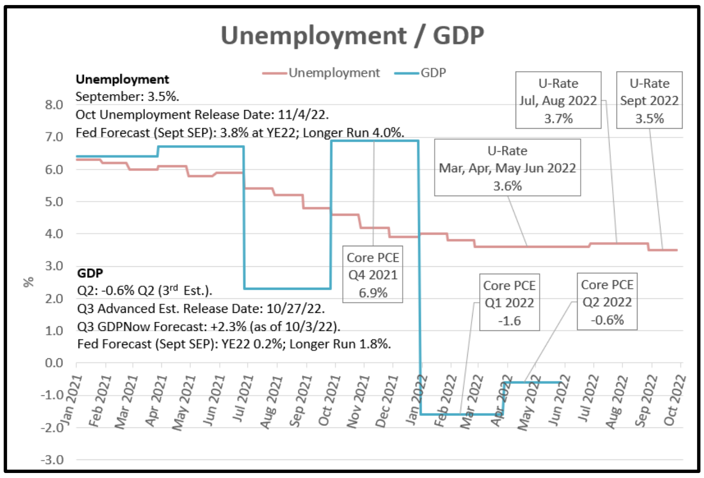
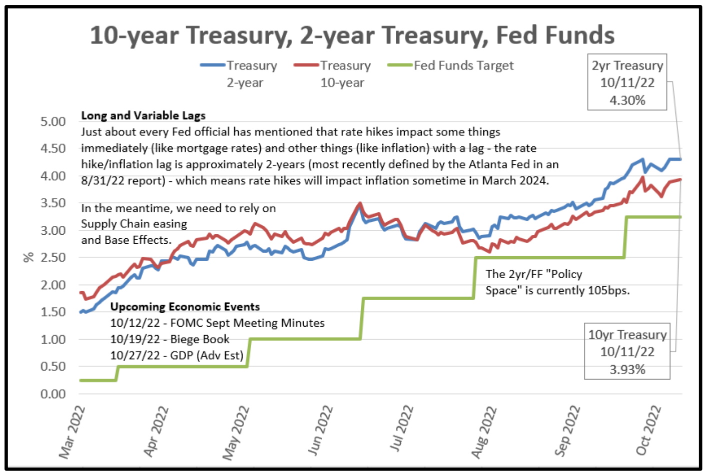
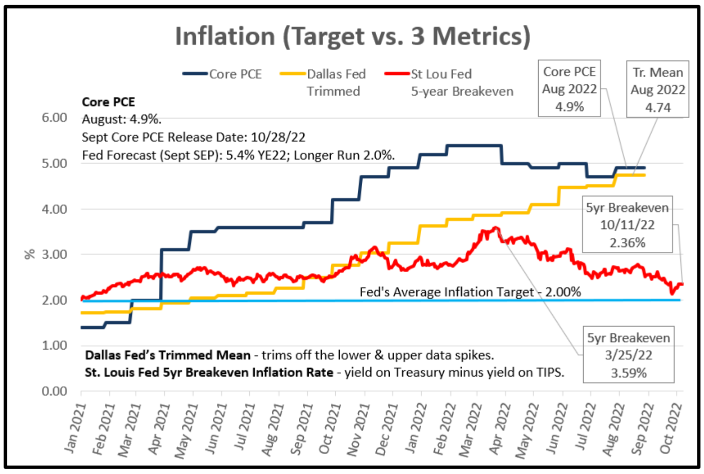
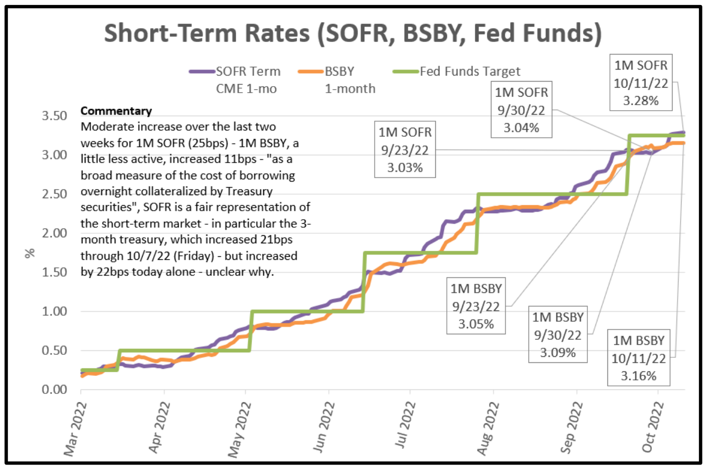
Economic Indicators

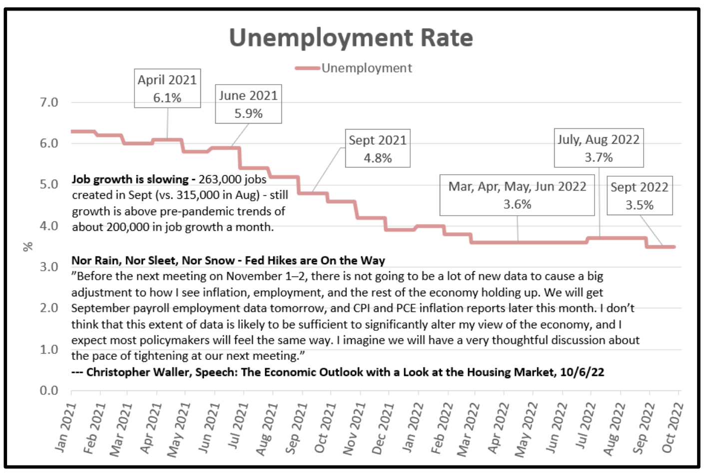
Trends

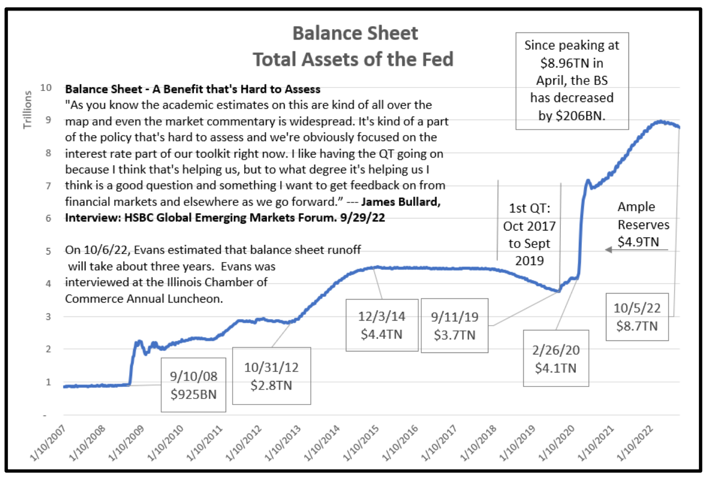












Must Reads

NY Fed, Report: Computer Saturation and the Productivity Slowdown, 10/6/22	4 pages	Absolutely fascinating read about computers/productivity and how a computer's contributions to productivity ended in 2005.
Charles Evans, Interview: Illinois Chamber of Commerce Annual Luncheon, 10/6/22	8 pages	A very candid conversation with Illinois chamber about inflation, the process the Fed goes through when making their decisions and what kind of rate hike to expect in November.
James Bullard, Interview: HSBC Global Emerging Markets Forum, 9/29/22	14 pages	A wide range of topics covered, including the unknown impact of QT, how we don't want to repeat history and the similarities btwn the economic conditions of the pandemic and the last two world wars.