Fed Unfiltered

WEEKLY REPORT 10/31/22

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Overview

FOMC – This Week a Rate Hike and Talk about Lags and Pauses

- A 75bps rate hike is expected at this week's FOMC meeting.
- Based on the September SEP and Fed commentary, another 50bps hike in December is likely, although expect a less unified Fed and a Dove/Hawk discussion centered around the level of upcoming hikes (50bps or 25bps) and the pace of the final few hikes (continuing to front load or to pause).
  - Currently, the endpoint for this rate hike cycle is either 4.75% (Sept SEP has Fed Funds peaking at 4.6% in 2023) or at 5.00% (Mary Daly interview on 10/21/22).
  - Although, rate hikes have an immediate effect on investment & borrowing rates, it can take up to 2-years for rate hikes to impact inflation (Atlanta Fed, report 8/31/22), which would be sometime in Dec 2023.
  - In speeches and interviews, we'll likely see Fed commentary continue to clarify the terminal rate and talk more about monetary policy lags and pausing rate hikes (see some pre-blackout comments below).

Calendar

- The Fed meets Tues/Wed with a policy decision at 11am (Pacific) on Wed – October's unemployment numbers will be out on Friday – October's CPI is out the following week.

November	
11/2/2022	FOMC Meeting, November 1-2
11/4/2022	Employment Situation - October 2022
11/10/2022	Consumer Price Index, October 2022
11/23/2022	FOMC - Minutes of the FOMC, November 1-2, 2022
11/30/2022	Gross Domestic Product, 3rd Quarter 2022 (Second Estimate)
11/30/2022	Biege Book, October 2022
December	
12/1/2022	Personal Income and Outlays, October 2022 (aka Core PCE)
12/2/2022	Employment Situation - November 2022
12/3/2022	FOMC, Blackout Period, December 3-15
12/13/2022	Consumer Price Index, November 2022
12/14/2022	FOMC Meeting, December 13-14

Key Metrics

- GDP – Q3's 2.6% growth (primarily driven by exports) was an improvement over the first two quarters of the year (Q1 -1.6%; Q2 -0.6%) – although, with the strong dollar and slowing global demand, such robust export growth is not likely to continue – economic analysts are expecting negative GDP in the first half of 2023.
- Core PCE – the costs of goods, not including food and energy, increased 5.1% YoY in September – shy of the Feb/Mar peak of 5.4% - and with cooling demand, easing of supply chain issues and base effects – economic analysts are expecting inflation to moderate in the coming months.

	Current	SEP Forecast for YE22	Target or Long Run	Next Release Date
Fed Funds (FOMC)	3.25	4.4	2.5	11/2/22
Unemployment Rate	3.5	3.8	4.0	11/4/22
GDP	2.6	0.2	1.8	11/30/22
Core PCE	5.1	4.5	2.0	12/1/22

Speeches and Interviews

Bullard – A Return to "Ordinary Monetary Policy" in 2023

- Bullard's version of saying pause: "And then in 2023, I think we'll be closer to the point where we can run what I would call ordinary monetary policy or a monetary policy where now you're at the right level of the policy rate and you're putting downward pressure on inflation, but you can adjust as the data comes in."

  James Bullard, Interview: Bloomberg TV, 10/19/22

Evans – The Fed's Path to Peak Fed Funds will be Complicated

- "There are lags in inflation and how it responds to monetary policy. Even though we've front loaded our monetary policy response and things are very restrictive at the moment, it's going to take time still to work on these more stubborn high price increases. So, that's going to complicate our path and ultimate path to a peak federal funds rate."

  Charles Evans, Speech: 2022 Community Bankers Symposium, 10/21/22

Mester – Can't just Increase Rates Until Inflation is Back to 2%

- "Monetary policy acts with a lag on the economy so we need to be forward looking. It is unlikely that we have seen the full effects on households and businesses of the latest rate increases we have implemented and it would not be appropriate to continue moving rates up until inflation is back down to 2 percent. But it is also the case that based on Fed communications, financial conditions began to tighten well before our first rate increase in March."

  Loretta Mester Speech: An Update on the Economy and Monetary Policy, Perseverance in Returning to Price Stability, 10/11/22

Reports

Inflation – Unemployment Might Go Higher than Fed Expects

- "Looking forward, we can forecast inflation if we specify the path of unemployment and the future behavior of the Beveridge curve and inflation expectations. There is much uncertainty about these factors, so it is difficult to make unconditional predictions. Yet we have one broad finding: The forecasts of Fed policymakers—inflation will return to target while unemployment rises only to 4.4 percent—are reasonable only under quite optimistic assumptions about both the Beveridge curve and expectations. If the behavior of either proves less benign, then reducing inflation is likely to require higher unemployment than the Fed anticipates."

  IMF, Report: Understanding U.S. Inflation During the COVID Era, 10/28/22

Savings – A Needed Buffer if the Economy Starts to Slow

- "We estimate that U.S. households accumulated about \$2.3 trillion in savings in 2020 and through the summer of 2021 … Since late last year, households have decumulated about one-quarter of these excess savings."
- "In summary, our estimates suggest that households across the income distribution continue to have a buffer of excess savings to help them navigate higher prices and/or a tightening cycle. While this buffer is dwindling, for now it is likely still providing some needed balance sheet support that could help to stanch a negative feedback loop were the economy to slow."

  Fed Board, Report: Excess Savings during the COVID-19 Pandemic, 10/21/22

Trends

Rates were down last week – geopolitical tensions and worries about a near-term recession most likely the cause – although inflation news on Friday reminded the markets that rate hikes are on the way, despite it all – the 3m/10yr treasury spread (the most reliable indicator of an upcoming recession) inverted on Tuesday and remained inverted the rest of the week – possibly not a blip this time – the most recent 3m/10yr inversion lasted four months (5/23/19 to 10/10/19), averaging a negative 20bps.

Key Interest Rates	10/24/22	10/25/22	10/26/22	10/27/22	10/28/22	5-Day Change
Fed Funds Target Rate (FFTR)	3.25	3.25	3.25	3.25	3.25	0.00
BSBY - Overnight	3.104	3.102	3.103	3.104	3.103	(0.001)
BSBY - 1-month	3.460	3.460	3.505	3.542	3.615	0.155
SOFR - Overnight	3.010	3.020	3.030	3.040	0.000	0.030
SOFR - 30-Day Average	3.025	3.025	3.026	3.028	3.030	0.005
SOFR - Term Rate - 1-Month	3.627	3.646	3.669	3.729	3.744	0.117
US Treasury - 3-Month	4.16	4.14	4.11	4.13	4.18	0.02
US Treasury - 2-Year	4.50	4.42	4.39	4.30	4.41	(0.09)
US Treasury - 10-Year	4.25	4.10	4.04	3.96	4.02	(0.23)
US Treasury - 20-Year	4.59	4.45	4.38	4.32	4.38	(0.21)
YC Spread - 3-Month / 10-year Treasury	0.09	(0.04)	(0.07)	(0.17)	(0.16)	(0.25)
YC Spread - 2-Year / 10-year Treasury	(0.25)	(0.32)	(0.35)	(0.34)	(0.39)	(0.14)

Quote of the Week

"Simplicity is the ultimate sophistication."
--- Leonardo da Vinci