Fed Unfiltered

FED REPORTS - Best of the Week

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NY Fed – Connecting the Cyber World to Real World

- “Stablecoins serve as both a means of payment and store of value for a range of DeFi transactions and could be used more generally to buy goods and services in the future. Stablecoins tie their value to the value of a real-world asset such as the US dollar through a variety of stabilization mechanisms.”
- “This note categorizes these stabilization mechanisms as one of three types: off-chain collateralization, on-chain collateralization, and algorithmic. Understanding a stablecoin's particular stabilization mechanism helps identify the potential risk of a run on the stablecoin in times of stress, when users might panic amid lack of information about or appreciation of the possible scenarios that might be triggered by a stablecoin breaking the peg.”
https://fedunfiltered.com/ny-fed-report-the-stable-in-stablecoins/

IMF – Monetary Easing and the Stock Market

- “Monetary easing and large-scale liquidity provision by central banks—while essential to ease financial market dysfunction—boosted investor risk appetite aggressively, resulting in asset price misalignments and increased nonfinancial sector leverage. In the U.S., for example, the equity market rally that started immediately after the Fed’s announcement to establish corporate credit facilities on March 23, 2020, continued relentlessly until the end of 2021 with the S&P 500 index rising by over 100 percent during this period. The surge in stock prices halted only after the Fed announced speeding up the tapering of its asset purchases in December 2021 and brought forward the plan to hike policy rates amid persistently high inflation. The exuberance on the part of equity investors during the pandemic has not been in line with macroeconomic fundamentals, creating a misalignment in equity prices of magnitudes comparable to the dotcom bubble in the 1990s.”
https://fedunfiltered.com/imf-report-macro-financial-stability-in-the-covid-19-crisis-some-reflections/

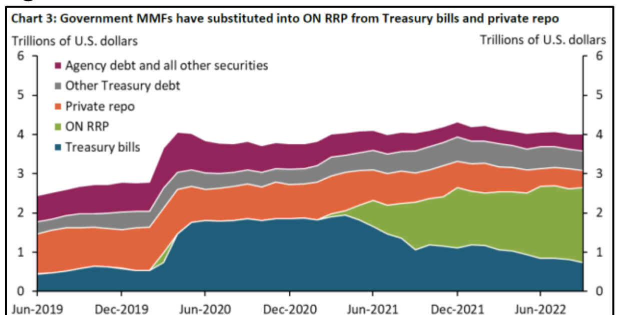
St. Louis Fed – Amidst High Inflation, Banks or T-Bills?

- “T-bills are more liquid than CDs but have about the same level of safety and maturity, so we would expect CDs to pay a higher rate to compensate for the difference in liquidity. However, this is not the case: In November 2022, a 12-month CD paid a rate of 0.6%, with 3-and 6-month CDs paying even less. At the beginning of 2022, bank deposits paid similar interest rates to T-bills, but they now pay almost 4% less. Thus, bank deposits essentially function as holding cash and can be a bad choice for holding liquid wealth in the current high-rate and high-inflation environment.”
https://fedunfiltered.com/st-louis-fed-report-where-do-you-keep-your-liquid-wealth-bank-deposits-or-t-bills/

KC Fed – Shift to ON RRP Presents a Challenge to Fed

- “Aggressive policy tightening also increased uncertainty about the pace of tightening and the terminal rate. ON RRP (Fed’s Overnight Reverse Repo Facility, an alternative investment for money market investors) access shields counterparties from interest rate risk, which is critical when policy uncertainty is elevated … Chart 3 shows that while Treasury bills (blue area) once made up the largest government MMF investment, their share has declined with lower bill supply and higher interest rate risk. Meanwhile, ON RRP usage (green area) continues to grow faster than not only Treasury bills but also private repo and agency debt.”
- “The current situation of declining reserves and rising ON RRP usage presents a challenge to the FOMC’s objective to shrink the Federal Reserve’s balance sheet. With reserves currently declining faster than assets, reserves could decline to a level consistent with an ample reserves regime without significant reductions in the balance sheet.”

Chart 3: Government MMFs have substituted into ON RRP from Treasury bills and private repo



Sources: SEC, U.S. Treasury Office of Financial Research, and authors’ calculations.

https://fedunfiltered.com/kc-fed-report-is-bank-capital-regulation-driving-continued-use-of-the-overnight-reverse-repurchase-on-rrp-facility/

UP TO SPEED --- Inflation (PCE vs. CPI)

PCE is a broad index of prices focused on the consumer in the U.S., with index weighting updated monthly. This is the Fed's preferred inflation measure. CPI measures the price changes for a basket of goods and services purchased by the typical urban consumer, with index weighting adjusted every two years. Core PCE/CPI excludes food and energy – both are published monthly.

James Bullard, Essay: Making Sense of Inflation Measures, 9/8/22
https://fedunfiltered.com/james-bullard-essay-making-sense-of-inflation-measures/

St. Louis Fed, Report: Inflation, Part 2: How Do We Construct and Choose an Index? 6/22/22
https://fedunfiltered.com/st-louis-fed-report-inflation-part-2-how-do-we-construct-and-choose-an-index-6-22-22/

Quote of the Week

"If you're going through hell, keep going."
--- Winston Churchhill