FOMC Policy Alternatives- Hawkish or Dovish?

At 2 pm ET, the Fed?s FOMC will update monetary policy. Given the Fed?s role in managing liquidity, investors should be very interested in how the FOMC talks about inflation, growth, interest rates, and QT, as well as any adjustments they make to monetary policy. The table below from ING provides interesting guidance on what we might expect. While we agree on the range of possible outcomes, we disagree on ING?s hawkish-dovish characterizations. ING believes the base case is moderately hawkish. Using their table, we think it?s hawkish. Many FOMC members, including Jerome Powell, want to keep policy rates at 4% or higher and keep them there through next year. We also disagree with them on interest rates. As we discussed yesterday, markets imply a .75bps rate hike, which we believe is hawkish, not moderately hawkish. A 100bps rate increase would be very hawkish.

Scenario analysis: The Federal Reserve's alternatives

	Inflation outlook	Growth outlook	Interest rates	Quantitative Tightening	24 hour reaction 10Y Treas (3.45%)	24 hour reaction EUR/USD (1.00)
Current stance	Inflation remains elevated. Fed "highly attentive" to risks	Growth to slow below potential, soft landing will be "challenging"	Target rate range at 2.25-2.5%, no decision on when to slow rate hikes	Balance sheet reduction $60bn of Treasuries, $35bn MBS from September		
Dovish	Deteriorating outlook to get core PCE deflator below 2.5% in 2023	Forecast indicate recession fears with unemployment above 4% in 2023	**50bp hike.** Worsening outlook suggests slower pace of tightening.	Unchanged	3.35	1.02
ING Base Case (moderately hawkish	Infl. revised up in near term, but end 2023 forecast remains near 2.7%	Recession risks are high, but Fed emphasizes the focus is on inflation	**75bp hike.** Fed dot plot and comments point to rates heading to 4.25%	Unchanged	3.45	1.00
Hawkish	Inflation risks becoming embedded, staying above 3% in '23	Fed indicates a mild recession needed to bring demand into balance with supply	**100bp hike.** Dot plot & comments indicate 4.5%+ rate	Discussion regarding swifter balance sheet reduction	3.60	0.99
Very hawkish	Inflation is embedded and remains above 3% through 2024	Recession required to have a material impact on inflation outlook	**125bp+** as Fed signals clear intent to crush inflation	Balance sheet reduction accelerates with asset sales	3.75	0.98

Source: ING

Scenario analysis: The Federal Reserve's alternatives

Posted on The Daily Shot 20-Sep-2022 @SoberLook

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What To Watch Today

Economy

- 7:00 a.m. ET: **MBA Mortgage Applications**, week ended August 12 (0.2% prior)
- 10:00 a.m. ET: **Existing Home Sales**, August (4.70 million expected, 4.81 million prior)
- 10:00 a.m. ET: **Existing Home Sales**, month-over-month, August (-2.3% expected, -5.9% prior)
- 2:00 p.m. ET: **FOMC Rate Decision** (Lower Bound), September 21 (3.00% expected, 2.25% prior)
- 2:00 p.m. ET: **FOMC Rate Decision** (Upper Bound), September 21 (3.25% expected, 2.50% prior)
- 2:30 p.m. ET: **FOMC Press Conference**

Earnings

	Company	Time	Estimate		Growth (Show only confirmed?)	Surprise
LEN	Lennar Corp.	4:30 PM ET	$4.77	$9.03 B	30.1%	+ = -
GIS	General Mills, Inc.	7:00 AM ET	$1.00	$4.69 B	3.3%	+ = -
KBH	KB Home	4:10 PM ET	$2.69	$1.87 B	27.5%	+ = -
TCOM	Trip.com Group Limited	6:00 PM ET	$0.12	$540.72 M	-40.7%	+ = -
FUL	H.B. Fuller Company	4:05 PM ET	$1.05	$945.72 M	14.4%	+ = -
SCS	Steelcase, Inc.	4:05 PM ET	$0.13	$885.20 M	22.1%	+ = -

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Market Trading Update

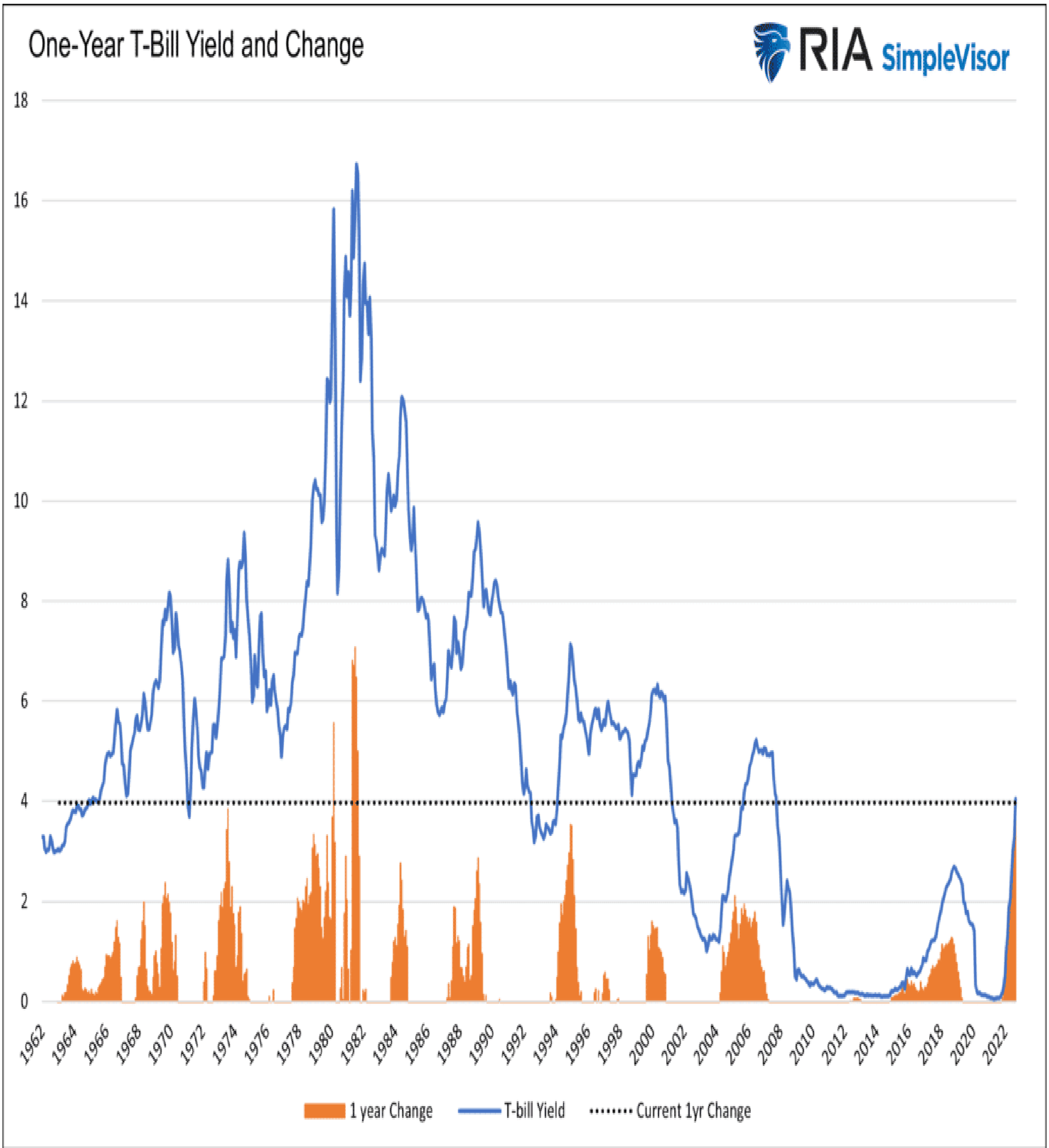
After a small rally yesterday, the market sold off ahead of today?s FOMC meeting announcement. After the surprise comments by Jerome Powell at Jackson Hole, the markets were unwilling to take on risk ahead of the meeting announcement. We expect a 75bps hike today with no real change to the messaging, which could provide a bit of a relief rally to the markets. As shown, the support level did give way yesterday, which will be critical for the market to recover by the week?s end. Otherwise, we will likely see a test of the July lows.

As noted, the markets are oversold, but the ?sell signal? remains intact, keeping downward pressure on stocks. We suggest using any rallies toward the 50-dma as an opportunity to reduce risk and raise cash levels as needed.

TradingView

Are 4% One-Year T-Bills A Good Investment?

The graph below shows the long-term history of one-year T-bill yields and compares the recent surge in yields versus prior periods. While many investors focus on the 4% yield and the fact that it is now at its highest point in almost 15 years, the bigger story is the recent surge in yields. In just one year, the one-year yield has risen 4%. The last time yields rose that much in one year was about 40 years ago.



One-Year T-Bill Yield and Change
RIA SimpleVisor
18
16
14
12
10
8
6
4
2
0
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
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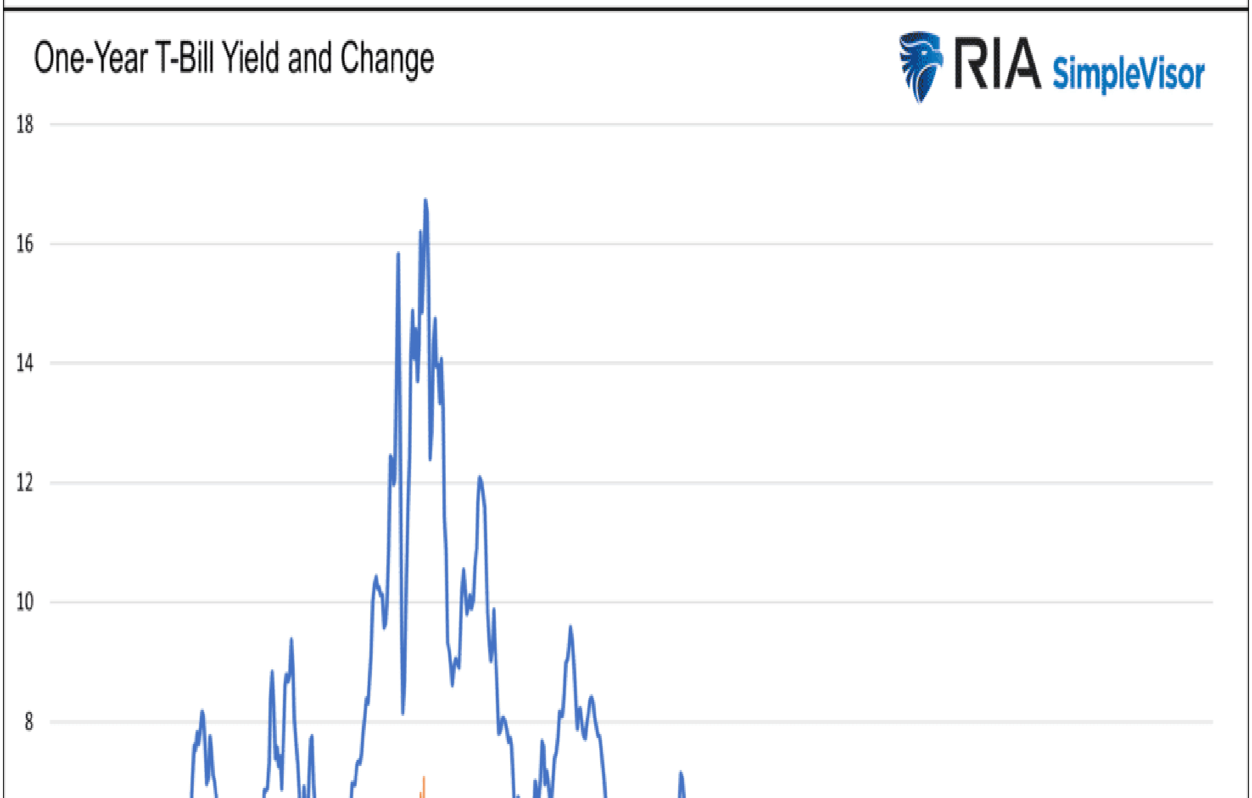
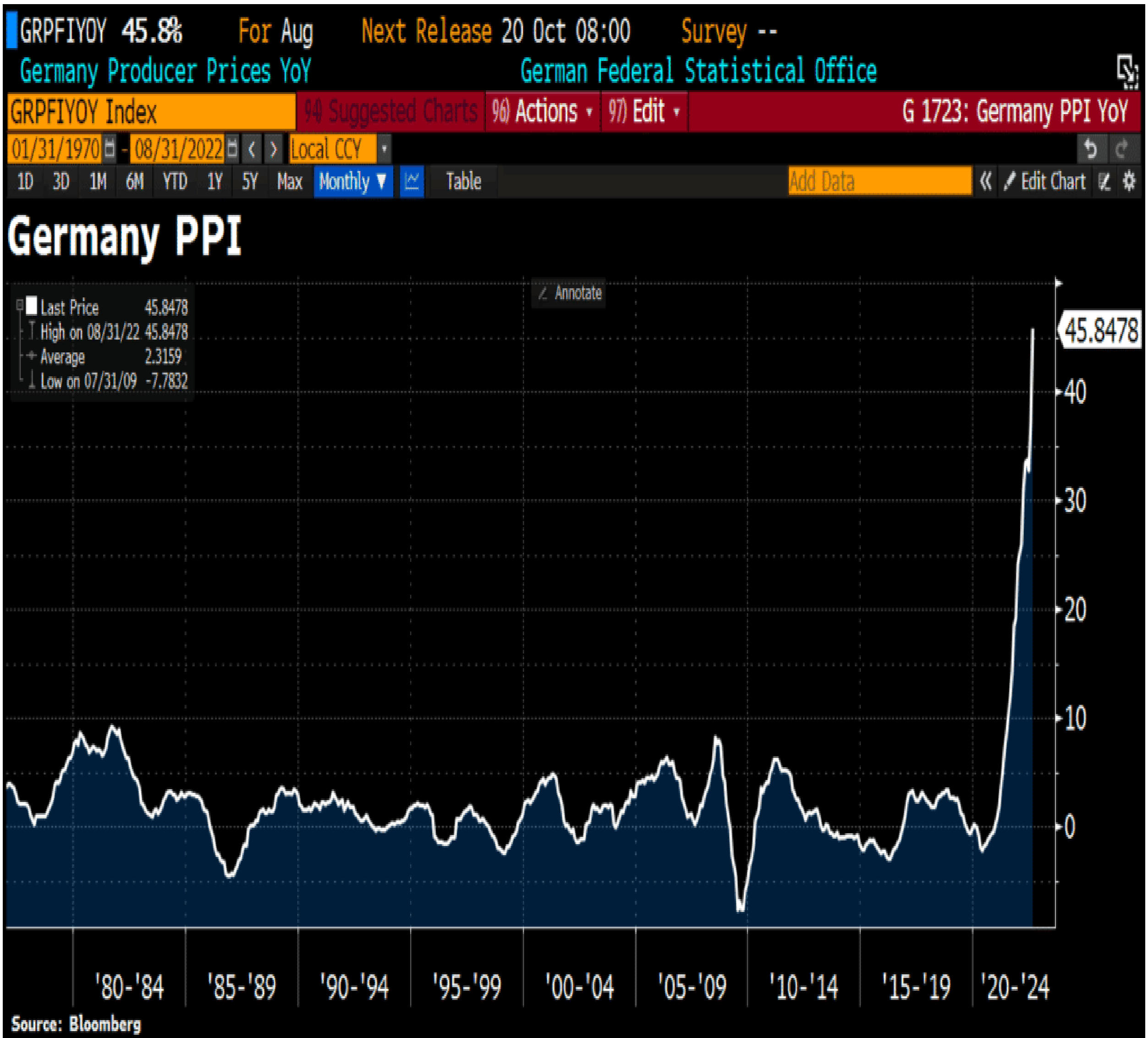
2022
1 year Change
T-bill Yield
Current 1yr Change



One-Year T-Bill Yield and Change
RIA SimpleVisor
18
16
14
12
10
8

German Inflation Off The Charts

Germany?s year-over-year PPI accelerated to 45.8% in August from 37.2% in July. As shown below, that is the largest annual price increase since at least 1949. The monthly figure jumped by 7.9% in August, also the highest monthly increase since 1949. Germany is a major industrial power. There is little doubt that its manufacturers and chemical producers will pass on these rising costs to its customers, many of which are U.S. companies. German PPI will keep pressure on U.S. PPI and CPI.


GRPFIYOY 45.8% For Aug Next Release 20 Oct 08:00 Survey --
Germany Producer Prices YoY German Federal Statistical Office
GRPFIYOY Index 94) Suggested Charts 96) Actions 97) Edit G 1723: Germany PPI YoY
01/31/1970 - 08/31/2022 Local CCY
1D 3D 1M 6M YTD 1Y 5Y Max Monthly Table Add Data Edit Chart
Germany PPI
Annotate
Last Price 45.8478
High on 08/31/22 45.8478
Average 2.3159
Low on 07/31/09 -7.7832
45.8478
40
30
20
10
0
'80-'84 '85-'89 '90-'94 '95-'99 '00-'04 '05-'09 '10-'14 '15-'19 '20-'24
Source: Bloomberg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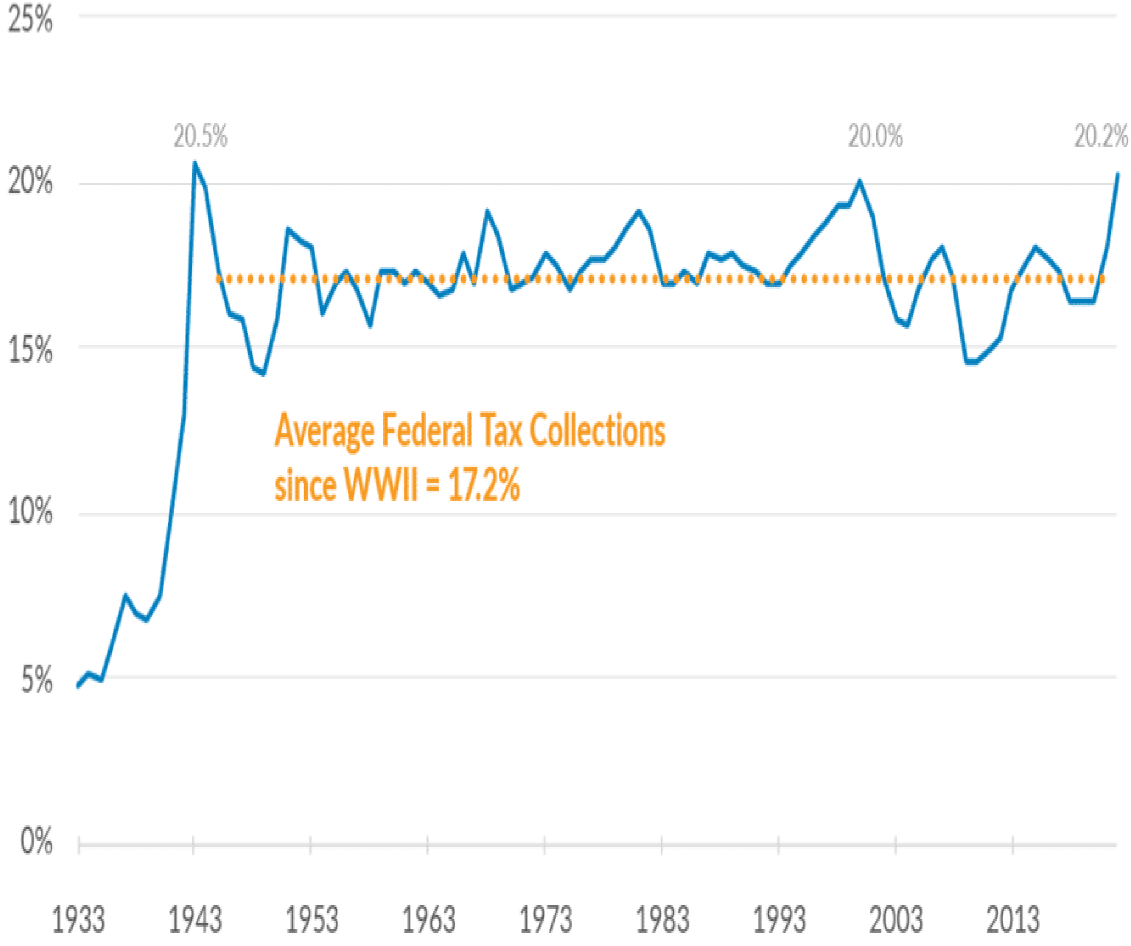
Fiscal Tightening is Underway

It?s not just the FOMC and monetary policy that is slowing economic activity. The graph below from the Tax Foundation shows that Federal tax collections as a percentage of GDP are 3% above the average of the last 70 years and even more so versus the last 20 years. Further, they are at their highest point as a percentage of GDP since WWII. Larger tax collections mean less consumption and will negatively impact economic growth. We will have to watch this closely to see if the recent high will likely stay at current levels or is just a temporary reaction to the massive fiscal response during the pandemic.

Federal Tax Collections Approaching a Record High

Total Federal Tax Revenue as a Share of GDP (1933-2022)



Source: OMB, CBO, Tax Foundation forecast based on CBO MonthlyBudget Review.

TAX FOUNDATION @TaxFoundation

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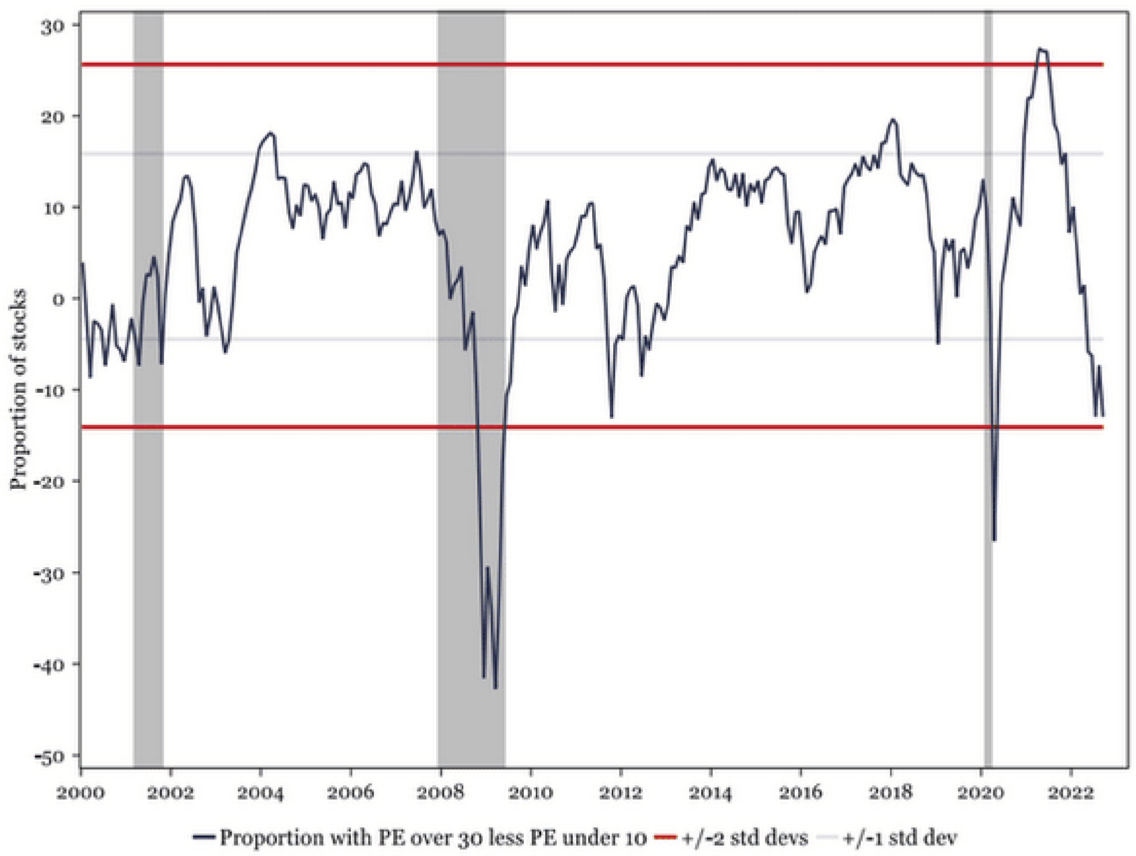
Tweet of the Day

Longview Economics
@Lvieweconomics

Our ‘overvalued less undervalued’ model (i.e. the proportion of stocks over 30 less under 10) is close to -2 std deviations (once again, at levels, usually only seen at bear market lows).

Fig 9i: Proportion of US stocks with a PE ratio over 30 less PE ratio under 10



Source: Longview Economics, Macrobond

Longview Economics
@Lvieweconomics

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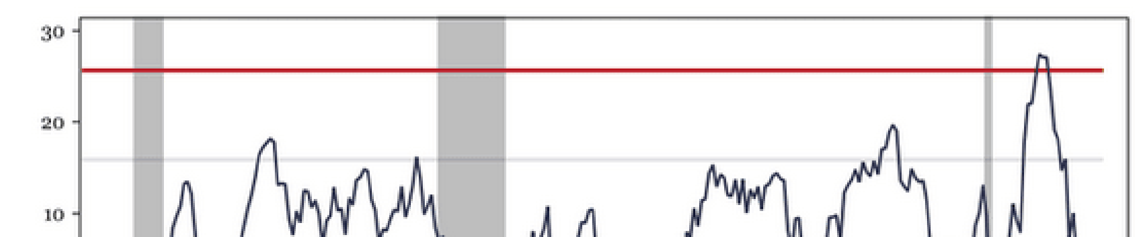

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