newsquawk

NEWSQUAWK PREVIEW: FOMC decision due Wednesday 16th March 2022 at 18:00GMT/14:00EDT; Powell presser at 18:30GMT/14:30EDT

The Fed Funds target range is expected to be lifted by 25bps in the first hike since COVID-19 with inflation running hot and the labour market widely considered close to full employment. The accompanying SEPs are expected to signal a string of hikes to follow this year in wake of ramped inflation forecasts, countered with lower growth forecasts. The guidance will be gauged to see whether FOMC is moving towards the market pricing of front-loaded hikes (seven this year), or a more measured three/four hikes. The uncertainty around the Ukraine invasion has pushed back on the chances of 50bps hikes, but the door is still open. Powell could provide more details around balance sheet reduction, but plans/launch are not to be finalised until mid-2022.

HIKE INCREMENT: The majority of Fed officials have come out in support of a 25bps liftoff for the Federal Funds target range, particularly in wake of the Ukraine uncertainty. Fed Chair Powell said in his testimony in the Capitol that he thinks it is appropriate to hike by 25bps in March. Although he warned if inflation doesn't begin to come down, "we're prepared to raise by more than that amount in a meeting or meetings", keeping the door open on 50bps in future meetings. A Reuters poll of economists saw all respondents forecast a 25bps hike, while 20/37 economists saw the risk of a 50bps hike later this year as high or very high. Rates markets are implying a 5% chance of a 50bps liftoff. On administered rates, the majority expect the IOR (currently 0.15%) and RRP (currently 0.05%) to both be hiked by the same 25bps increment with money markets having been stable and the effective Federal Funds rate comfortably within the target range.

RATE PATH: Bloomberg's survey has 28% of economists seeing the March statement indicating a hike in May, 45% expect signalling for a string of increases, and 28% see no forward guidance in the statement. Meanwhile, the Dot Plot is expected to signal more hikes are to follow this year in the Fed's efforts to get the Fed Funds closer to neutral (largely seen at 2.5%). Powell has said that every meeting is live for 2022, but the broader discourse has seen a binomial outlook develop, with one camp leaning towards three/four hikes while the other leans towards the mid-to-high single digits, corroborating with market pricing. On which, after a Ukraine-induced unwind in market hike pricing in early March, rates markets are now back to pricing seven 25bps hikes by year-end, supported recently by the hawkish ECB and given the Fed has been undeterred in its policy outlook in wake of the invasion. The cooling of market volatility has helped.

BALANCE SHEET: Powell has said balance sheet normalisation/reduction plans will not be finalised at the March FOMC but will occur some time after the initial rate lift off. Little new details have been touted by officials in wake of the announcement made at the January confab either, where the Fed released its Principles for Reducing the Size of the Federal Reserve's Balance Sheet. Powell may use the upcoming FOMC to give a calendar guide to when the process will begin, where expectations range largely for the rolloff to begin between July and September. And potentially on pace and composition, with Bloomberg's median survey of economist estimates seeing the balance sheet at USD 8.5tln by 2022-end compared to the current USD 9tln area, and another USD 1tln reduction is expected in 2023. Meanwhile, amid some calls for faster MBS roll-off, most economists don't expect a faster relative pace of MBS vs Treasuries reduction to begin with, although the Fed has kept the door open to that possibility going ahead, with some officials touting potential outright sales, instead of the current rolloff plans.

FINANCIAL CONDITIONS: A big part of the argument for 25bps liftoff instead of 50bps is the already realised deterioration in financial conditions, tightening the flow of credit to the economy. Goldman Sachs' Global Financial Conditions index hit its tightest since May 2009, tightening 130bps since the Ukraine invasion, and adding to the increased certainty of central bank tightening paths that were already beginning to affect conditions beforehand. That tightening has been accentuated by a spell of funding pressures amid the market volatility, seen in lower stocks and record-breaking commodity strength, playing into credit spread widening. Note the recent cooling of those pressures, however. Albeit, the market is already tightening and the Fed now needs to ratify those expectations with its liftoff, but there's less urgency to surprise too hawkishly.

INFLATION: Headline Feb CPI rose 7.9% Y/Y, with the core not far behind at +6.4% as price pressures become more broad based. Figures were in line with the Wall St consensus and presumably a slight sigh of relief for policymakers that there wasn't another right tail print, albeit still at alarming levels. Further, given the approaching commodity shock, the Fed will now be viewing the figures as a base to grow off/sustain, rather than a peak that was expected before the Ukraine invasion. Even after the Feb NFP saw signs of cooling wage growth and easing price spiral fears, it's noteworthy

Copyright © 2022 Newsquawk Voice Limited. All rights reserved.
Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.
newsquawk.com · +44 20 3582 2778 · info@newsquawk.com

Fed's Evans (non-voter; last speaker ahead of FOMC blackout) on CNBC said the report didn't change much for the Fed and took the time to warn about further approaching inflation, with particular concern around food prices. Indeed, the Feb CPI report saw food prices rise 1% M/M, the largest since the early COVID period, with risks skewed to the upside ahead given the rally in ags. And that's not to mention the already lofty 3.5% spike in energy M/M, and over 25% rise Y/Y. The Fed has largely kept a cool head to look through the inflation, with the party line being the anchoring of longer term inflation expectations keeping credence to the idea that the pressures will recede. However, the recent breakout of market-based, longer-term inflation expectations post-Ukraine will be raising eyebrows and emboldening tightening plans, with 5yr5yr CPI swaps rising further towards their 2013/14 peaks of 3% and away from their 2% target.

DOTS: Bloomberg's economist survey sees the FOMC raising its PCE forecasts for 2022 to a 3.9% median from 2.6% in December, cutting its 2022 GDP median to 3.3% from 4.0%, while maintaining the unemployment median at 3.5% for the next several years, according to the survey. *Median dot expectations via Bloomberg's survey*:

- **FEDERAL FUNDS RATE**: exp. at 1.1% in 2022 (prev. 0.9% in Dec), 1.9% in 2023 (prev. 1.6%), 2.38% in 2024 (prev. 2.1%), 2.5% in longer run (prev. 2.5%)
- **CHANGE IN REAL GDP**: exp. at 3.3% in 2022 (prev. 4.0% in Dec), 2.2% in 2023 (prev. 2.2%), 2.0% in 2024 (prev. 2.0%), 1.8% in longer run (prev. 1.8%)
- **UNEMPLOYMENT RATE**: exp. at 3.5% in 2022 (prev. 3.5% in Dec), 3.5% in 2023 (prev. 3.5%), 3.5% in 2024 (prev. 3.5%), 3.5% in longer run (prev. 4.0%)
- **PCE INFLATION**: exp. at 3.9% in 2022 (prev. 2.6% in Dec), 2.5% in 2023 (prev. 2.3%), 2.1% in 2024 (prev. 2.1%), 2.0% in longer run (prev. 2.0%)
- **CORE PCE INFLATION**: exp. at 3.3% in 2022 (prev. 2.7% in Dec), 2.4% in 2023 (prev. 2.3%), 2.1% in 2024 (prev. 2.1%)

Disclaimer

The information contained within this document has been prepared and issued by Newsquawk Voice Limited (**"Newsquawk"**) on the basis of publicly available information and other sources believed to be reliable. Whilst all reasonable care is taken to ensure that the facts stated are accurate, neither Newsquawk nor any of its directors, officers or employees shall be in any way held responsible for its content or your use of it. Neither the provision of any content herein nor anything on our website or any other media we use is intended to, and should not be construed as, providing advice and/or enticing an offer or solicitation to invest in, buy or sell securities or other financial instruments.

Copyright © 2022 Newsquawk Voice Limited. All rights reserved.

Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.

newsquawk.com · +44 20 3582 2778 · info@newsquawk.com