

WILL IT BE A “FOUR”GONE CONCLUSION?

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If you look back over the first eight months of this year, it is truly amazing to see how the money and bond markets’ [monetary policy](#) outlook continues to change. [Quantitative tightening \(QT\)](#) was the “easy” part, as most market participants correctly saw this coming as part of the policy shift. It’s the [rate hike](#) aspect of the equation that continues to undergo what seems like ongoing transformations. Now, as we enter the final third of the 2022 calendar year, investors are being presented with yet another new “twist.” Could Powell & Co. raise the terminal rate for [Fed Funds](#) to the 4% threshold?

After pricing in a very [hawkish Fed](#) in mid-June, [Fed Funds Futures](#) reversed course quickly only about a month or so later. Indeed, multiple [rate cuts](#) began to dominate the narrative for the second half of 2023 as signs of economic weakness became prevalent. Over the course of the last few weeks, a “funny” thing began to happen; the economic data was pointing toward activity not “rolling over.”

Obviously, there are two sets of data the Fed and, by extension, the markets have been closely following. The first one is inflation; the second is the labor market. Although recently released numbers on [inflation](#) suggested a crest may have occurred, price pressures remained elevated. On the employment front, the August jobs report shows that the U.S. labor market continues to be on solid footing. Take these two factors together, and you get a hawkish Jackson Hole speech like Powell delivered a little more than a week ago.

Initial Weekly Jobless Claims



Source: St. Louis Fed, as of 9/2/22.

Let’s look at the aforementioned jobs data a little more closely. Once again, total nonfarm payrolls visibly rose more than expected, and the job gains were widespread. The unemployment rate did rise 0.2 pp to 3.7%, but this uptick was the direct result of a surge of +786,000 in the civilian labor force—typically a sign of strength, not weakness. In addition, the alternate civilian employment measure increased by a hefty +442,000.

What about future labor market trends? This is where initial weekly jobless claims can be a useful guide, given its characteristic of being considered a leading economic indicator. A great deal of attention was given to the increase in claims from its nadir in March of this year to the recent “peak” in mid-July. Since then, claims have actually been falling. As the above graph illustrates, the level is essentially unchanged from when we began 2022 and is considerably below

the readings of a year ago.

This brings us back to the Fed. There is no doubt the policy maker's number one goal is to bring down inflation, but in order to get there, Powell reiterated at Jackson Hole that some softening in labor conditions will be required. Based on recent jobs-related data, we're not close to being there at this point.

Conclusion

For the September 21 [FOMC](#) meeting, the upcoming [CPI](#) report could very well tip the balance for either a 50- or 75-[basis-point \(bp\)](#) rate hike. From my perspective, don't get caught up in that debate, but rather focus on the point that the voting members will take the Fed Funds target visibly higher than where it currently stands. If you believe some recent comments from Fed officials, "4%" could be in play during early next year, with no rate cuts on the table. Stay tuned...

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DEFINITIONS

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Quantitative Tightening : Quantitative easing is a process whereby a central bank targets lowering longer-term interest rates by purchasing bonds and other securities to stimulate the economy. Quantitative tightening is the reverse process whereby securities are either sold or the proceeds of maturing securities are not reinvested with the goal of tightening economic conditions to prevent the economy from overheating.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Federal Funds (Fed Funds) : Excess reserves that commercial banks and other financial institutions deposit at regional Federal Reserve banks

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Fed fund futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

Rate Cut : A decision by a central bank to reduce its main interest rate, usually to influence rates charged by other financial institution.

Inflation : Characterized by rising price levels.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Consumer Price Index (CPI) : A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Basis point : 1/100th of 1 percent.