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Expeditiously

Jay says they will move “expeditiously”
By raising Fed funds inauspiciously
As well they’ll reduce
That balance sheet juice
Which fueled the bubble propitiously

So, you will have already read much about the FOMC meeting and the Powell presser but here is my take. Inflation remains their key concern right now, but they are deathly afraid of a recession. As such, they seem pretty comfortable with the market pricing of 50bp hikes for June and July because they believe if that’s what they do, it will not force any further ructions in financial markets. They are also completely uncertain as to how reducing the balance sheet is going to impact things but don’t want to really admit that as Powell knows that QE is going to be an important tool going forward to help fund the government.

In fairness to Powell, there have been a wide range of estimates as to the impact the growth of the balance sheet has had on things and really there is no consensus view on how its unwinding will turn out. Sometimes market participants overthink things though, and my sense is that is exactly what is happening here. Since the first round of QE in the wake of the GFC, we have seen an extraordinary amount of funds creation by the Fed which helped support significant growth in leverage in the economy. That is evident in the extended prices in stocks, bonds and other financial assets (crypto anyone?). If the Fed removes those funds, the support for asset prices is going to be impaired, and that means prices for all of them are likely to decline further. Whether or not that has an impact on the real economy is not so clear, but I expect it will have a very big impact on financial asset prices, and not in a good way.

While growth in the US remains
Ok, though we might feel some pains
Elsewhere on the earth
It seems there’s a dearth
Of strength or a future of gains

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One of the key features of the Powell comments was about the strength of the US economy and how the Fed actually needs to moderate that somewhat in order to tackle inflation. Alas, for many other nations, they need to tackle inflation without the benefit of a strong economy. For instance, this morning we got more negative data from Europe as German Factory Orders (-4.7% in March) greatly disappointed, as did French IP (-0.5% in March). These are not the numbers that the Madame Lagarde wants to see as she tries to address the ~~runaway~~ rising inflation across the Eurozone. Adding to the weakening growth story was last night's Caixin PMI Services data from China, which fell far more than forecast to 36.2. Other than the Covid crash in February 2020, this is by far the lowest print ever seen. It appears that locking down the largest city with the most economic activity in the country had a negative impact on growth. How surprising! Of more concern, though, is the fact that Xi's zero Covid policy looks set to bring massive restrictions across all of Beijing soon, which is not going to help the situation at all.

In the end, as I have written before, the world's central banks are in quite a pickle. More than a decade of printing money and monetizing government debt has resulted in a situation where any substantive fiscal expansion leads directly to higher inflation. In order to break this cycle those same central banks who did everything in their power to prevent even the slightest downturn are now going to have to cause a significant recession in order to stem inflation's tide. There have been very few central bankers in history who have been willing to do that in the past and there is exactly zero evidence that the current cadre of central bank heads in charge have the resolve to fight inflation. I fear that we are going to see a permanently higher equilibrium level of inflation, rising from the last 40 years' 1.5%-2.5% up to 4.5%-5.5% going forward. (There is a great podcast that discusses this with @inflation_guy called "*The Weighing Machine*". I highly recommend investing the 50 minutes to hear what he has to say.)

And with that pleasant thought, let's turn to the overnight session activity. On the whole, I guess you would have to call the price action quite positive. In the wake of the FOMC, US equities exploded higher, closing up by ~3% on the day as Powell removed the idea of a 75bp rate hike from the conversation and allowed that the market had done a good job pricing the expected trajectory of rates going forward. This relief rally occurred after Europe had closed so it is not that surprising to see European bourses all in the green (DAX +1.45%, CAC +1.75%, FTSE 100 +1.1%) despite the weaker than expected data releases. In Asia, while China returned from their holiday (Shanghai +0.6%), the Hang Seng (-0.4%) which has been open didn't seem to find any love and the Nikkei remains closed for one more day. However, after that bold rally here, US futures are currently lower by about -0.5% or so.

In the bond market, Treasuries had quite a day yesterday, trading above 3.0% early in the session before tumbling on the Powell talk, trading slightly below 2.90% before closing around 2.94%. This morning those yields have backed up 2.8bps and quite frankly, still look like they are going to break through 3.0% decisively at some point. Meanwhile, Bunds (+1.9bps) are also tracking toward a big, round number, 1.00%, and it only seems a matter of time before they trade there. Gilts (-2.2bps), on the other hand, are rallying slightly ahead of the BOE meeting which is due to end in just minutes.

Oil had an impressive day yesterday, rising 5.3%, but today it is little changed, consolidating those gains. The impetus there has been the ongoing clarification of Europe's plans to stop importing Russian oil and products, although there is no clear answer as to where the replacement will come from. NatGas (-0.1% in US, +2.4% in Europe) is consolidating after its own 5.3% rally

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yesterday and now sits firmly above $8.00/mmBTU in the US. While this is the highest level we have seen here in 14 years, it is still only about one-quarter the price in Europe.

Flash, BOE Raises Base RATE 0.25%, as expected, in a 6-3 vote, with the three dissenters looking for 50bps

Elsewhere in the commodity space gold (+0.8%) continues to benefit from reduced concerns over Fed hawkishness while copper (+0.1%) and aluminum (+0.1%) are barely moving on the day.

Yesterday afternoon saw the dollar shed about 1% across the board in the wake of the FOMC meeting, but it is in the process of recouping that now. The pound (-1.0%) is lagging today as there were some market participants who were looking for a more hawkish BOE. However, given they just forecast a recession in 2023, that seems a bit far-fetched. But AUD (-0.7%) and NOK (-0.7%) are both under pressure as well with the entire G10 bloc falling this morning. Quite frankly, this seems very much like a trading reaction as investors try to determine the likely outperformers based on new interest rate input. In the EMG bloc, only THB (+1.3%) is showing any real strength today as it responded to the less hawkish FOMC by benefitting from equity market inflows. However, most other currencies in this space are softer led by ZAR (-1.4%) and TRY (-0.9%) with the former giving back half of yesterday's outsized gains on the Fed while the latter is responding to this morning's remarkable CPI report at…70% Y/Y! That, my friends, is a problem.

On the data front, this morning brings Initial Claims (exp 180K), Continuing Claims (1400K), Nonfarm Productivity (-5.3%) and Unit Labor Costs (10.0%) with the last two numbers certainly a concern from a macroeconomic perspective. There are no scheduled Fed speakers today but we do get two tomorrow after we see the payroll report.

The Fed has made their bed for now. A 50bp rate hike seems almost certain in June, barring substantially weaker growth data. The market is pricing in July and September as well, but that is a long way from now. At this point, I would suggest the dollar removed its weak hands yesterday and that more long dollar positions are set to build from here. We shall see.

Good luck and stay safe
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