FED WATCH: BACK-TO-BACK IN THE HISTORY BOOKS

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The Fed made it back-to-back by raising the Fed Funds Rate another 75 basis points (bps) at the July FOMC meeting. This brings the new target range up to 2.25%–2.50%. Similar to last month's convocation, the voting members confronted another higher-than-anticipated CPI print prior to their policy gathering and were faced with a market expectation for a potentially even more aggressive move. However, unlike, the June meeting, the policy makers decided to maintain the "status quo" and not break new ground by raising rates by a full percentage point.

With this latest move, the current Fed Funds target now matches the peak range implemented during the last rate hike cycle that ended in late 2018. However, there's one big difference: the speed at which this target range was established. During the last rate hike cycle, it took three years to get to this point, while the present scenario only took four months.

That brings us to another interesting observation. After implementing unprecedented policy measures to combat the adverse effects of the COVID-19 lockdown, the Fed has now arguably utilized unprecedented steps to bring down inflation. If my eyes don't deceive me, in modern monetary policy history, the Fed has never hiked rates by back-to-back 75-bp increments, which has led to an incredible total of 225 bps' worth of rate increases in just four months' time. Think about it for a minute…as recently as March 15 of this year, Fed Funds were still at "zero"! Yes, we've blogged before about the Fed "front-loading" its rate hikes, but this takes it to another level.

Oh, and don't forget about quantitative tightening (QT). Thus far, this shrinkage of the Fed's balance sheet has flown under the radar, much like Powell & Co. had hoped. As of this writing, the Fed's holdings of Treasuries (UST), MBS and agency securities have declined by only $17.6 billion since QT began on June 1. Interestingly, the UST drawdown has come in at a little more than $36 billion, but the MBS position has actually increased by nearly $19 billion. In other words, QT has not yet really begun in any visible fashion. According to the Fed's own "Plan for Reducing the Size of the Federal Reserve's Balance Sheet," the pace of QT is expected to pick up speed and reach maximum monthly drawdown levels beginning in September.

What can we expect for the remainder of 2022? I already addressed QT, and that should essentially be on autopilot for now. Rate hikes? That's another story. On this front, the most important consideration is that the Fed should continue to raise rates at the three remaining FOMC meetings this year, with the only unknown being by how much at each gathering. Powell & Co. are just about as data dependent as I've ever seen in their decision-making process on that front. Given some of the recent data intimating that a visible slowing in the economy is already occurring, the policy makers may decide to "tone down" the magnitude of rate hikes going forward and let the aforementioned QT "kick in" and do some of the lifting as well.

Conclusion

The bottom-line message is that bond market volatility has increased dramatically, with the UST 10-Year yield exhibiting "whipsaw" characteristics. Although the Fed will more than likely continue on its rate hike path for the rest of 2022, the unknowns presented by where the U.S. economy and inflation may be headed, and the attendant Fed response, should keep the "volatility quotient" elevated accordingly.

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

Basis point : 1/100th of 1 percent.

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

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.

Inflation : Characterized by rising price levels.

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.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Volatility : A measure of the dispersion of actual returns around a particular average level.