THE NEW FED DEBATE: SKIP VS. PAUSE OR PAUSE VS. CUT?

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05/24/2023

The money and bond markets find themselves in an interesting spot on the calendar, nestled right between the May and June FOMC meetings. However, based upon recent price action and Fedspeak, perhaps the argument can be made that the markets find themselves in another far more important place, debating what comes next from Powell & Co.

At the May FOMC gathering and accompanying Fed Chairman's presser, it certainly appeared as if the Fed was guiding the markets into thinking this was potentially the last rate hike in this cycle. At a minimum, the voting members were either at or close to the end, anyway, and that monetary policy was likely to enter into a pause mode. Certainly, future policy decisions were now going to be on a meeting-to-meeting basis and very data-dependent.

Against this backdrop, the U.S. Treasury (UST) and Fed Funds Futures arenas were continuing to discount the possibility that rate *cuts* would be the next topic for the policy debate, with the timing and magnitude for such a shift becoming rather aggressive at times. Indeed, only one day after this month's FOMC meeting, futures markets had a rate cut fully priced in for July and a one-in-three chance for a cut at the June convocation.

Then a "funny" thing happened in this data-dependent world the markets now live in: the U.S. jobs data came in with another solid showing, no doubt throwing cold water on the aforementioned rate cut expectation timetable. In addition, while inflation gauges continued to reveal signs of further cooling, core measures, such as CPI, showed price pressures remaining well above the Fed's liking.

That brings us to last week's Fedspeak and what some were calling the new monetary policy debate: "skip or pause." Some Fed officials seemed to be suggesting that a June rate hike was still on the table depending on…the data. In fact, Dallas Fed President Logan, an FOMC voting member this year, stated the policy makers could "skip a meeting" even though she still feels further tightening could be warranted. Along these lines, one was getting the sense post-Fedspeak that voting members are undecided on the immediate next steps for policy, so why not "skip" the June meeting and, if need be, raise rates in July? This premise appears to be completely at odds with what the UST market has been discounting.

My motto has always been, when in doubt, look to the Fed Chair. Powell did not disappoint on that front, as he weighed in, saying the Fed "can afford" to look at incoming data and make its decisions accordingly, especially given the huge number of rate hikes that have been implemented over the last year. Another point we have been mentioning and seemed to be confirmed by Powell is that the Fed may use tighter post-Silicon Valley Bank credit conditions as their own type of rate hike.

Conclusion

In my opinion, instead of spending too much time on the "skip vs. pause" debate, it's probably more useful to ponder how long a pause may last before rate cuts. From Powell's perspective, it appears he is not a fan of the "stop and go" approach to rate movements. And, if you noticed, essentially none of the Fedspeak I discussed here mentioned rate cuts. That is the disconnect between the Fed and the UST market that will have to get resolved at some point.

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Bond market : The bond market—often called the debt market, fixed-income market, or credit market—is the collective name given to all trades and issues of debt securities. Governments typically issue bonds in order to raise capital to pay down debts or fund infrastructural improvements.

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

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

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.

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.

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.

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

Inflation : Characterized by rising price levels.

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.