Weekly Market Summary

March 15th, 2022

Latest Fed's Thinking - Geopolitics, Stagflation & Powell's Soft Landing Attempt
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The Fed's QE is officially over! On March 9th, 2022 the Federal Reserve conducted their final open market purchase effectively ending the Covid QE program started in March 2020.

During their Jan. 25-26 meeting, Fed officials concluded that they would soon start raising rates from near zero and were on alert for persistent inflation that would justify a faster pace of tightening. The Fed meets again on March 16th to decide on interest rate increases and steps to address the rising inflation phenomenon. The FOMC will most likely raise interest rates for the first time since 2018.

This decision will come after an unrelenting drumbeat of elevated inflation readings. Under normal circumstances, the inter-meeting data would support a 50-bp hike. But circumstances are currently extraordinary — oil prices that shot above $130 last week, before falling back down to below $100, demonstrated the unpredictability of war. Global financial markets are in a risk-off mood. Still, some FOMC members may support the larger hike, and could dissent from the majority on the committee.

Federal Reserve Chair Jerome Powell recently signalled to Congress that the committee will opt to raise the federal funds rates by 25 basis points initially. Mr Powell admitted that he was open to further interest rate increases further down the line if inflation, remains "persistently high." US consumer price growth approached 8 per cent last month. From a year ago, prices are up 7.9 per cent, the fastest annual increase since January 1982. Once highly volatile items like food and energy were stripped out, "core" CPI jumped 6.4 per cent over that period.

Meanwhile, the U.S. labor market remains strong, with record high job openings and record low layoffs. The four-week moving average of unemployment insurance continuing claims has fallen to its lowest level since March 28, 1970. Moreover, given that the U.S. civilian labor force has more than doubled since that time, the percentage of the labor force drawing continuing claims is now less than half what it was in March 1970. The Bureau of Labor Statistics reported a gain of 678,000 jobs in February, easily beating economists' estimates of 400,000 to 450,000 new jobs. The unemployment rate edged down to 3.8%.

Futures markets show around 175 basis points of tightening this year, or the equivalent of at least seven quarter-point increases. The key assessment for markets will be whether the hike is "dovish" — indicative of a cautious path ahead — or "hawkish," in which officials signal they are determined to keep raising rates to fight inflation even if there are some adverse effects on growth. Where the committee goes from there, however, is hard to tell. Members will update their projections through the "dot plot" — in which each official plots one dot on a grid to show where they think rates will go this year, the following two years and the longer range.

Most notably, the past weeks sent three important messages about the U.S. economy, markets, and the Federal Reserve. First, inflation is growing more embedded in the economy in a way that makes policy makers deeply uncomfortable. Second, more investors and consumers see the pace of price increases – and potential Federal Reserve response – as expediting an economic downturn. Third, although the collective wisdom of the markets suggests investors are sure where growth and inflation will end up, the path to getting there looks much more alarming.

Below is the latest pricing for 3-month Eurodollar interest rate futures contracts, which indicate the path of the futures interest rates from beg-2022 to End-2024. Data provided in the below table is as of 15th March, 2022:

Contract*	Last Close (%)	Contract *	Last Close (%)
Apr ‘22	1.195	Jun ‘23	2.530
May ‘22	1.365	Sep ‘23	2.560
Jun ‘22	1.475	Dec ‘23	2.510
Jul ‘22	1.565	Mar ‘24	2.415
Sep ‘22	1.770	Jun ‘24	2.345
Dec ‘22	2.115	Sep’24	2.315
Mar ‘23	2.340	Dec’24	2.320

**Contract start date always falls on the third Wednesday of the displayed month (i.e. market participants project a 3-month USD LIBOR of 1.19500% for Apr ’22 versus the current 3-month USD LIBOR of 0.82600%) - Source: Bloomberg.*