2 + 2 = 5

We discussed Orwellian Moments back in August, but yesterday's Fed meeting has confounded me (again) and left me trying to figure out some of their "math". But first, let's cover the ECB.

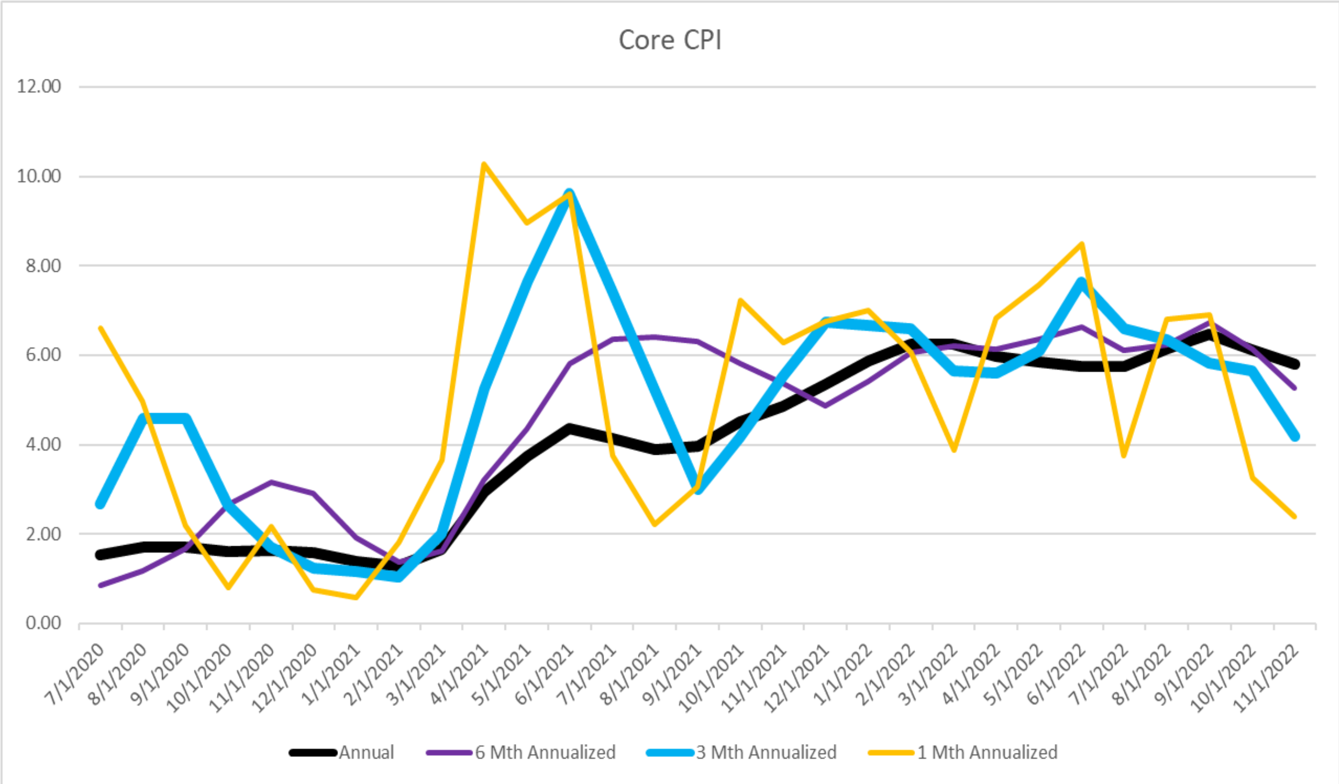
The ECB Made Sense

The ECB has been late to the rate hike party and has some catching up to do. They also have a serious inflation problem, but one that is different than ours. They were (and still largely are) incredibly dependent on cheap Russian energy to power their countries. That is a problem and is something that they have to combat. Today they did two things:

1. A "hawkish" 50 bps hike. They could have gone with more, but chose not to. However, Lagarde made it very clear that they are prepared to do more. While Powell made it somewhat clear that we were nearing the "wait and see" moment, the ECB did not. That pushed all yields in Europe higher.
2. They announced that their QT would start in March and be €15 billion. That seemed to hit markets hard and explains why Italian 10-year bonds are 10 bps worse than German and French bonds. If nothing else, hopefully central bankers are learning that QE distorts asset prices more than any other policy that they can enact, and those distortions are disruptive and difficult to unwind. For example, a relatively small amount of QT (starting 3 months from now) had a significant market impact today – scary to think about). **My one hope is that going forward central bankers will use QE only in the direst of circumstances and for the briefest time possible (in cautiously small amounts)**. Probably wishful thinking, but seems logical to me!

So, the ECB and the market's reaction to the ECB largely make sense.

Back to 2 + 2 = 5



This chart takes monthly core CPI (seasonally adjusted) and presents it in 4 ways: the sum of the 12 months, taking the prior 6 months and multiplying it by 2, taking the prior 3 months and multiplying it by 4, and finally just taking the most recent month and multiplying it by 12.

The big black line is the annual one that we all see and it is around 6%.

My favorite line is the light blue one, which represents the prior 3 months * 4. I like that because the data is recent and incorporates the impact that prior policy decisions should be having. Using 3 months "smooths" the data. That has been trending down for several months and is currently down to 4%. This is above the Fed's target of 2% (which Powell reiterated yesterday), but is hardly alarming. If anything, we probably should be talking about how to "flatten the curve" to get a soft landing (I already think that it is too late for that as you can read in Rise and Fall of Inflation Drivers and Squishy Landing).

If you simply take the latest month and annualize it, we were at 3.3% last month and 2.4% in the latest month (wow, almost like their policy has worked)! But instead, we have to focus on trailing 12 months, despite the impacts of higher yields and quantitative tightening needing more time to fully impact the system! **It is so Orwellian to me that it hurts!**

But that wasn't all that sent me back to this dystopian wasteland.

> "By the middle of next year, we should begin to see lower inflation from the housing services sector."

Powell said that. He knows that rents incorporate data from as much as 10 months ago. He knows as well as you and I do that it is a lagging indicator. He even said as much (at least that is how I interpret his comment). But why do we include it and base policy on it, knowing it is wrong! **The 3 highest prints for owner's equivalent rent in the past 30 years came in Q3 and Q4 this year. Simply impossible**, and even the Chair acknowledges that it will go down, but he is still acting on it as though it is legit!

I will continue to send charts of Zillow's data around and expand on this work that first started in earnest back in an October T-Report.

Imagine how low the prior 3 months of core data would be with proper housing inflation data. And yes, think of how high it really was last year when we were being fed the "transitory" story.

Finally, he highlighted jobs, which I will grant have been decent, but he seemed to ignore several things:

- The Household Survey hasn't been as good as the Establishment Survey (a couple million jobs difference).
- The survey response rates have been low, making people question their validity and if there is any "self-selection" bias in the reporting (companies doing well report, but maybe others don't).
- The Philly Fed thinks Q2 jobs were overstated by more than 1 million! Some group within the Fed tasked with figuring out how accurate the data is thinks that it was overstated by 1 million, which is more in line with the Household Survey!
- The JOLTS data has a high number of vacant jobs. The question is how overstated is that number? How has it kept up with online job searches?

We address many of the jobs questions in Inflation Dumpster Dive and More Inflation Dumpster Diving, and the Fed's own work on the subject is there for all to see.

If one part of the economy is doing better than expected (by some measures, but not all), I'd spend more time wondering if the good measures are accurate, rather than basing a large part of my policy on data that is the outlier!

And just today, sales numbers came in extremely weak and last month’s numbers were revised down! The consumer is buying for the holidays and buying on discount, and I expect that to evaporate as we head into the new year!

Bottom Line

The Fed should be taking a victory lap and figuring out how to avert a hard landing, but for some reason they insist on looking at old data (12 months, rather than data impacted by their actions), stale data (OER), and pollyannish data (the selective use of some jobs data) to signal that they want a higher terminal rate!

Good luck with that, because 2 + 2 does NOT EVER EQUAL 5!

I feel better after that rant, and I am buying the dip here in risk because I believe that the Fed speakers will sound a bit more dovish as they resume their speaking circuit, and it is a bit premature to trade the very hard landing (that I still expect will happen).

2 + 2 = 5

Disclaimer