Let Them Eat Expectations

The most "compelling" arguments for a 75-bps rate hike today and a hawkish posture going forward (125 bps or more in hikes over the next three meetings) are:

- Jobs data still seems strong.
- Not wanting to derail progress made on containing inflation expectations.
- Not wanting to derail progress made on tightening financial conditions.

On the surface, those arguments still seem weak to me given everything we've been highlighting in:

- Inflation Dumpster Dive
- Wile E. Coyote
- More Inflation Dumpster Diving

Ignoring all of those reasons, the criteria being highlighted as why the Fed "needs" to stay hawkish doesn't seem to merit the attention it is receiving.

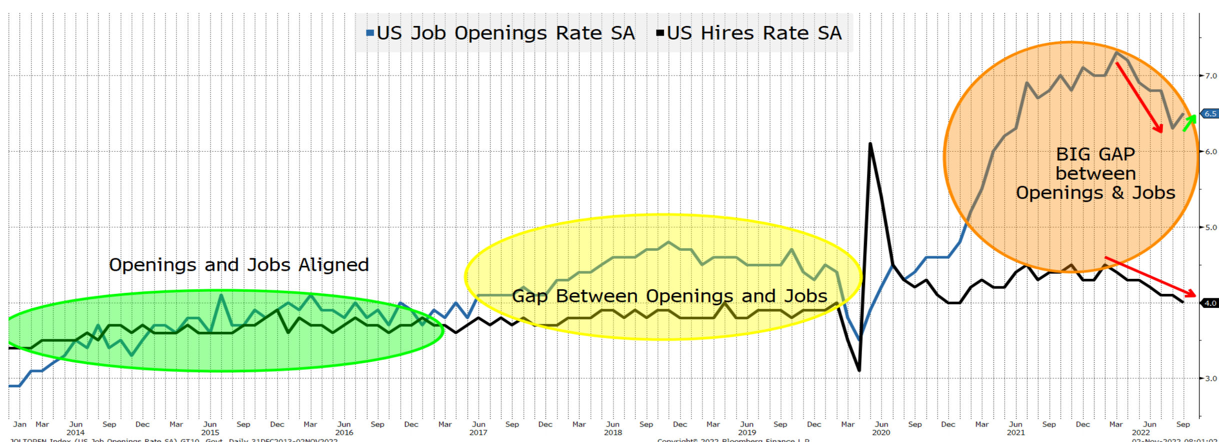
Jobs

ADP came out stronger than expected (239k) with a small revision to last month, but I'm not sure any of us have a good understanding of the new methodology's veracity. Last month, though it was slightly lower than the 263k NFP result, it was close enough to warrant attention.

Yesterday's JOLTS data turned a nice "everything" rally into a broad-based sell-off.

Let's take a look at some arguments against the reaction we had yesterday:

- **The data is for September**, which is already a month old.
- **The QUIT rate wasn't strong.** Many view the quit rate as being as important (or more important than) the total number of jobs. It was 2.7 for the third month in a row. It hasn't been below 2.8 for two months in a row since February 2021 (though it is still elevated relative to the pre-Covid average of about 2.3).
- **Hiring isn't matching the job openings!**

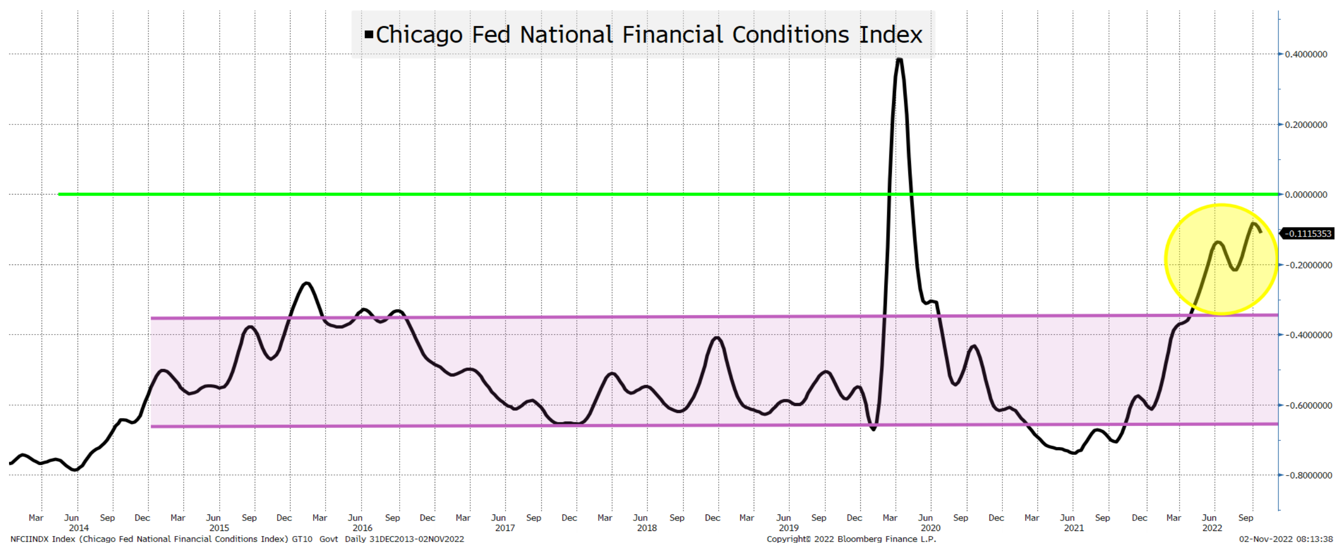


I often question the quality of the data and this data raises some questions around a complex subject. Have we changed how we "advertise" for jobs in a way that isn't being adjusted for? Do we post the same job to so many platforms that the BLS has trouble adjusting? Do we post for non-existent jobs, because it is cheap and easy to post, and you might get lucky with a "unicorn" application? I do not know why this gap is so big and is increasing, but it probably deserves some thought rather than just accepting that the data reflects the true story.

The jobs data remains the weakest argument from my side on why the Fed has already gone far enough, but the details rarely seem as strong as the headlines suggest.

Expectations, Breakevens, & Financial Conditions

Various financial conditions indices paint slightly different pictures. They are all generally similar, so I went with the Chicago Fed.



According to the Chicago Fed, we are still in "easy" money territory (below 0), but I'd argue that much like a boiling frog, we've gotten so used to easy conditions that we've reset the "norm" since the financial crisis. What was once "easy" money has become the "norm" so conditions are actually reasonably tight.

Stock prices factor into many financial conditions indices (as do credit spreads) so the rationale is somewhat logical that the Fed doesn't want to see stocks rise because that eases conditions. My issue with that argument is that at the best of times, trying to steer a massive economy using the whims of the stock market seems like a recipe for disaster and that is even worse now when liquidity is thin and day trading daily/weekly options has become all the rage.

On expectations, I'm going to have to spend a day or two figuring out why they are so important! I couldn't find any chart that makes me believe that expectations do a whole lot! Yes, in theory, if people think inflation will be high they buy more today creating higher inflation in the future, but try as I might, I couldn't illustrate that in a chart.

Breakevens seem to be subject to market whims (and a whole variety of issues shaping the curve), so breakevens are an output, not a driver. For all the concerns about letting breakevens get loose again, I'm not sure that the fixation is warranted.

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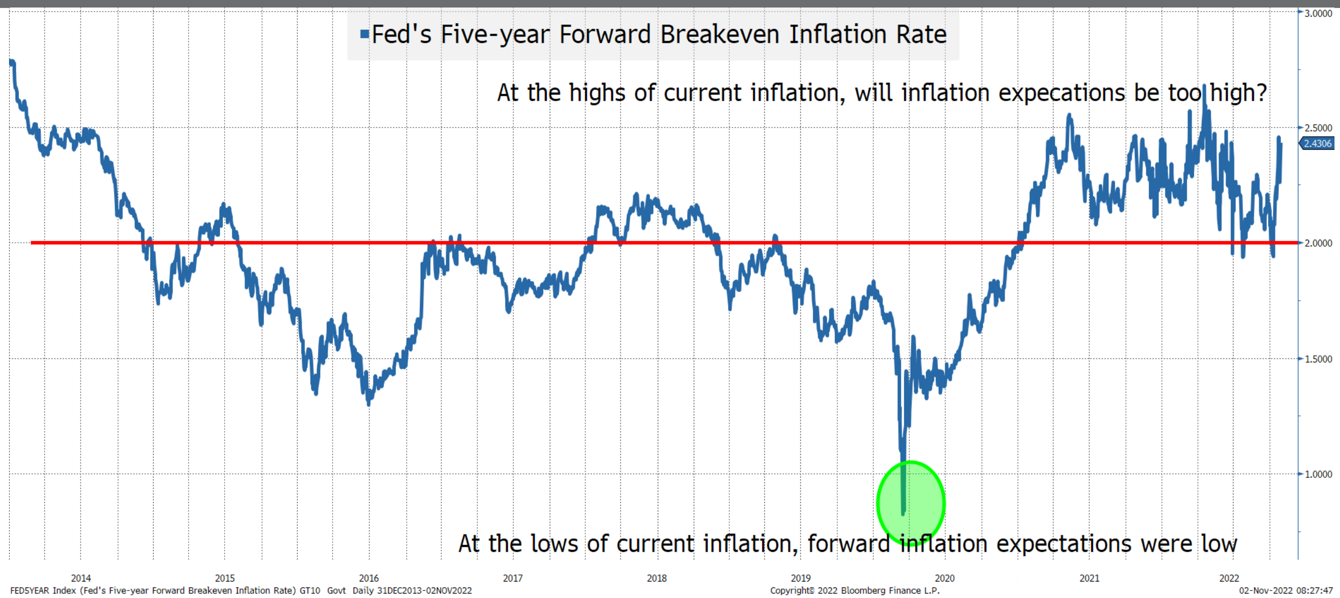

Maybe we should be focused on getting this below 2%. However, I don't lose sleep worrying about the likelihood that these expectations will ever turn out to be predictive rather than a function of a whole lot of factors influencing curves at any given time.

Bottom Line

We get 75 bps today. We will likely rue this day in the very near-term, but it is already priced in.

We get a heavy dose of "data dependency." This Fed wants to get to higher rates and leave them there for an extended period. I believe that the Fed has a horrible record of having to cut within months of hiking. They have every opportunity to manage down expectations for future cuts (**actually, the moment they say, "data dependent", we all think "fewer hikes" because we all believe that the data will be weaker going forward**). If that isn't a compelling enough reason to at least think about slowing hikes, I don't know what is.

According to WIRP (a function on Bloomberg), we have the following:

Today's meeting: Implied rate is 3.85% (75-bps hike). I don't like it, but seems correct.

December's meeting (on December 14th, right before two weeks of low liquidity): Implied rate is 4.44%. That is about 60 bps. I'd bet that by the end of today, that will be under 50 bps.

Feb 1st meeting: Implied rate is 4.81%, or about 100 bps from today. Could be 50/50 or 75/25, but I'd bet against that.

When looking at implied rates, I struggle to come up with a scenario where Powell is so hawkish that it isn't already priced in, meaning that there is potential for the "everything" rally to continue today because despite recent gains in stocks and bonds, no one has bet too heavily against the Fed changing its tune.

Good luck today!

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