US MACRO CHAT

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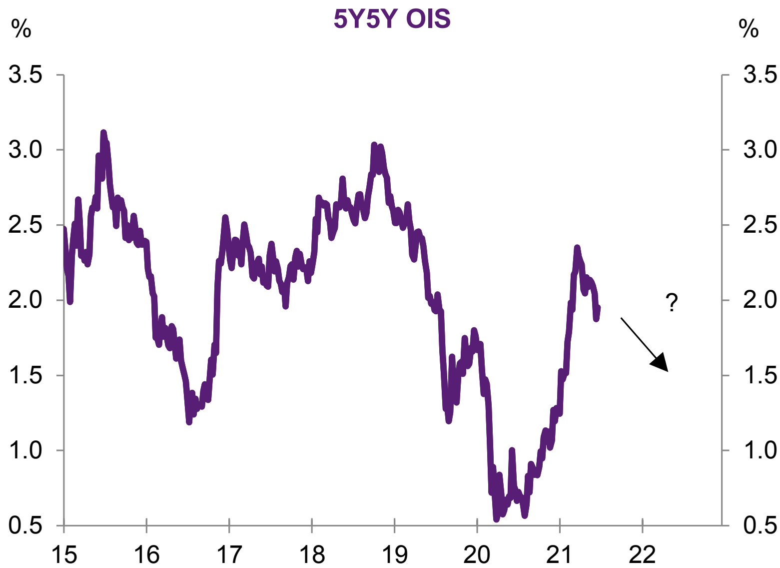
We Don’t Believe You

Financial markets (stocks and bonds) sold off in response to a more hawkish Fed scenario than what had been anticipated. The notorious “dot plot” now shows two 25 basis point tightenings in 2023, compared to none before. This more aggressive tightening trajectory has further galvanized discussion of when the Fed will taper its $120 billion per month in bond purchases ($80 billion in treasuries and $40 billion in mortgages). The futures market is pushing back against this policy narrative.

- The 5-year/5-year overnight indexed swap (OIS) captures investors’ expectations of the terminal or peak fed funds rate in the business cycle. When long rates were selling off earlier this year, the 5y/5y OIS rose to just under 2.40%. At the time, market participants were assuming that this next tightening cycle would look broadly like the last tightening cycle. Rates would rise from zero up to 2.40%. But since April, the 5y/5y OIS has sharply fallen, down to 1.86% last week. Following the FOMC statement, the futures market sold off, but only mildly. **The 5y/5y OIS is currently yielding 1.94%**. This is where the instrument was trading last Wednesday before the bond market had rallied to intra-quarter lows.
- To be sure, the futures market is telling us that it does not believe in a more aggressive Fed. Recent history has sided with the market, not policymakers. Witness the last tightening cycle in terms of duration and extent. It took seven years from the last rate cut (December 2008) to the first rate hike (December 2015) and then it took another year for the second rate hike (December 2016). In addition, the FOMC had to keep revising down its estimate of the long-run equilibrium funds rate, which was initially thought to be around 4%. The future markets led, and the Fed followed. **Given the uncertainty regarding the contours of another potentially large federal spending bill upwards of $4 trillion, investors are right to question whether the Fed can soon taper let alone bring forward the timing of tightening**. Recent history tells us Fed actions will occur later rather than sooner. Stay a tune to fiscal policy developments. We are.
- **Natixis launched its mid-year outlook survey earlier this month**. It provides keen market insights. The link to the survey is provided here. We thank you greatly in advance for your participation.



Sources: Natixis, Bloomberg

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