GLOBAL MACRO, ECONOMICS & RATES STRATEGY RESEARCH

Capital Markets

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Daily Deck

Fed: when will they stop? Oh, my…

The market has been hypersensitive to every monthly number. Every wiggle seems to matter. Forget about broad trends or if an indicator is lagging. Fine then, here is one for the radar: the CPI report we'll get two months from now (i.e., the March CPI which is reported in April).

Last year, the March 2022 report benefited from a large decline in used car prices (it was down -3.59% m/m). That helped drag down the m/m core CPI to just 0.3%. Here is the aesthetic problem. Our ***very, very*** early call is that March CPI (again, just so there's no confusion, the one reported this coming APRIL), will come in around 0.4%. If that's true, because of that easy year-ago comp, this will LIFT the y/y pace.

We can tell you all day long that the y/y pace is not what we should be looking at right now and that something like a 3-month annualized percent change is meaningfully better for gauging near-term direction. It doesn't matter. Aesthetically, at least as of right now, a lift in the y/y rate will not be a good look for the Fed. That report will come out just a couple of weeks prior to the May 3rd FOMC meeting.

So with that in mind, let's take stock here of a few things: Tomorrow's retail sales is likely to be solid, meaning Q1 growth is going to look pretty decent. That will only serve to embolden a market already looking for a rate hike in May. We think the next payroll report will slow from that outsized gain last month, but consistent with our view, it will still be solid. And, if a CPI report like we just highlighted comes about (the one reported in April), the current 60% chance (as of this writing) for another 25 at the JUNE meeting might be too low!

Keep in mind this will be all happening at a time when the Fed is seemingly (even by their own admission) nearing the finish line on hikes. We can easily see how this could get ugly. The Fed could find themselves in a tough place regarding stopping. Remember, hiking rates is not costless. It will come with eventual damage to the labor backdrop (even if that damage hasn't shown up yet, it will…see recent DDs for more on that).

So to avoid paying an even dearer price for those hikes in the face of labor that is set to slow and inflation that will continue to slow, the Fed will either need to come up with a narrative leading into/at the May meeting of "hey, we think we've done enough, and we are going to let all of these hikes marinate and do its thing." If they don't, we can easily see them getting caught up in all of those economic wiggles in the monthly data points and then the real risk is they find themselves just continuing to hike into even more restrictive territory which will have sharper growth implications for 2024.

Dallas Fed president Lorie Logan's speech today was lumped into the "hawkish" camp by some, but we heard some much-needed nuance. Yes, she said what seems to be the standard shtick these days about doing more if necessary to combat inflation. But she also highlighted that real rates are now "significantly restrictive" and the risk of overtightening means steeper job losses. She's totally right to say this if for no other reason than we need some officials to be on the other side of the argument! And not just for the sake of being on the other side, but because there is another side!

Between the anatomy of those coming data points we highlighted above and what feels like the need for more two-way chatter within the Fed, if they don't alter the conversation, they run the risk of doing way too much. As our regular readers no doubt appreciate, we think they should have stopped already.

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