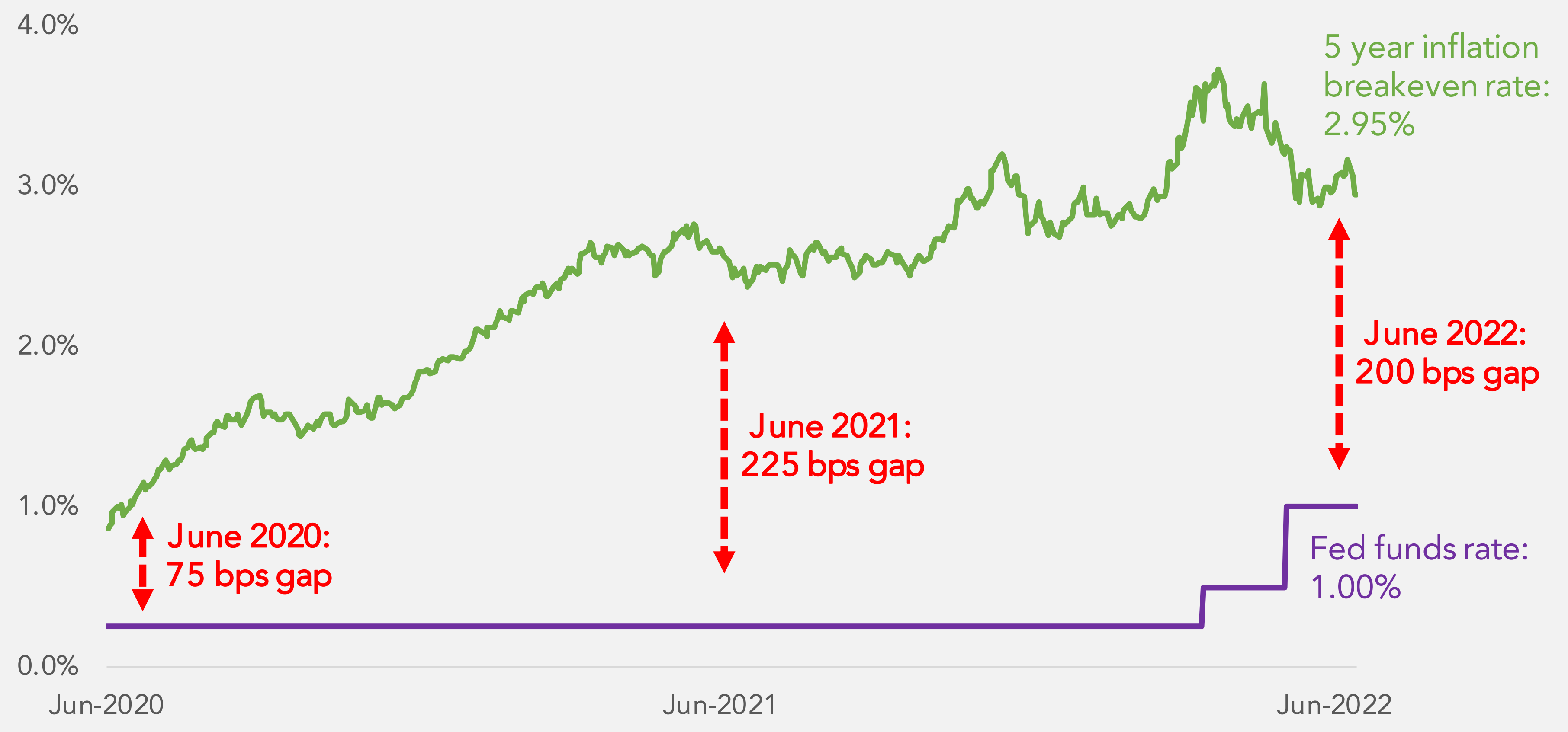
Capital Markets Strategy
Essential inCights for the C-Suite

MUFG

Chart of the Day

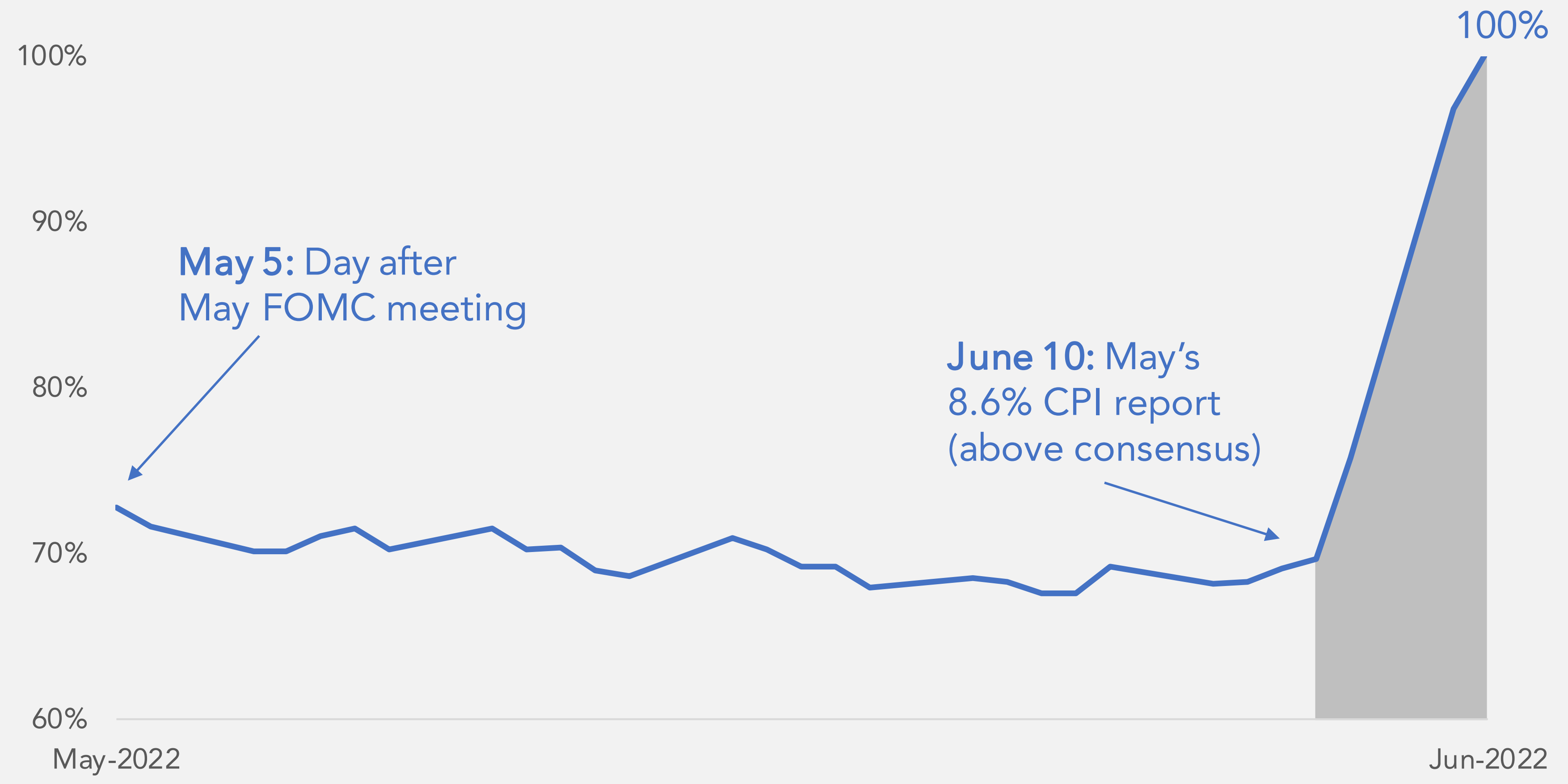
Having spent much of 2021 easing policy during a "boom" cycle, the Fed today finds itself well "behind the curve." The 200 bps gap between Fed Funds and 5 year breakeven inflation provides a measurable illustration of the policy gap that the Fed will look to partially close at 2pm today. The problem, of course, is that the Fed's late start and "demand side" toolkit will not address many of the "supply side" sources of inflation (food and energy prices, China COVID lockdown). To be sure, the Fed finds itself in a difficult position: the more they abandon gradualism, the more recession risk comes into view, as evidenced by inversions this week in the closely watched 2s-10s, 5s-10s and 5s-30s yield curves.

Fed Funds rate and 5 year inflation breakeven rate



Since Friday's "above consensus" CPI report defied expectations of "peak inflation" (8.6% Y/Y vs. consensus 8.3%), markets moved quickly to price a 100% probability of a 75 bps rate hike at today's FOMC meeting - the first such 75 bps hike since the historic Fed tightening of 1994. Although Chair Powell dismissed the possibility of a 75 bps hike just weeks ago, markets have anchored their views to the "data dependency" of Fed policy. In the end, a bruise to the reliability of Chair Powell's guidance may provide a needed boost to the Fed's institutional credibility.

Market implied probability of 75bps rate hike at June meeting



Source: (1-2) Bloomberg. WIRP Screen. Data as of June 14, 2022.

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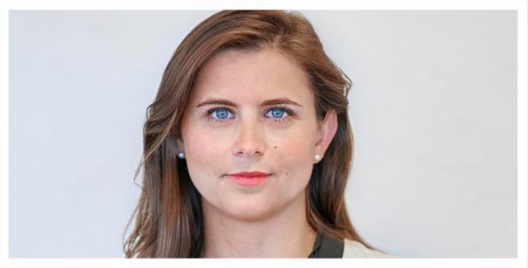

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