Strategy

JefMacro Weekly—A Fed Pivot on the Market's Brain

October 30, 2022

Key Takeaway

Zervos believes downside risks for spoos behind us; elevated level of nominal income growth backstop against pain from higher real rates/multiple contraction. GREED & fear's base case: China's gov't comes up with policy for unfinished residential projects. If nothing done, fear of hard landing grows. Credit market has Fed "pivot" on brain; recent data fed narrative. Aneta thinks root cause of inflation is excess demand, price pressures have shifted to services.

David Zervos—Jay's policy lifting should be completed by December. We are now headed into the final stages of this demand-destroying tightening move with Fed credibility fully intact. The current elevated level of nominal income growth is now providing a nice backstop against the pain we have had to endure from higher real rates/multiple contraction. We suspect most of the downside risks for spoos are now well behind us.

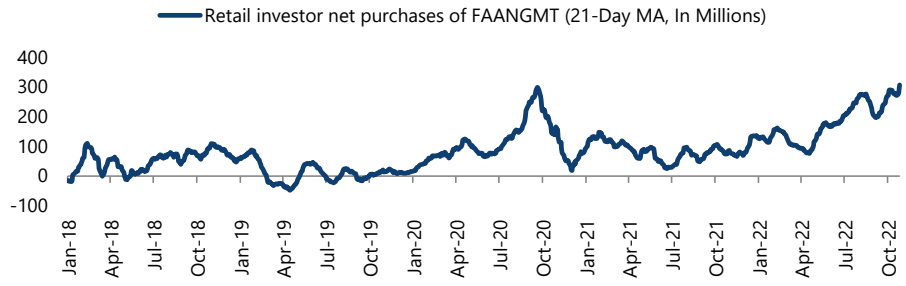
GREED & fear—Our base case is that the Chinese government will come up with some policy to address the issue of unfinished residential projects. But if nothing is done by the end of this year, fears of a hard landing will grow. That said, China's monetary and fiscal policy will remain orthodox given the PRC has traditionally been a hard money regime.

Aneta Markowska—In deciding whether it's appropriate to pivot, the Fed will be focused on the labor market. In order to achieve a broad-based and sustained slowdown in inflation, the Fed has to engineer a slowdown in labor costs. There's no evidence that's happening. The root cause of inflation is excess demand, That's why inflation remains sticky, price pressures have shifted, notably to services.

Sherif Hamid—The credit market has a Fed "pivot" on its brain. The recent data, weakish GDP and lower price deflators, plus some stabilization in the U of Mich survey, likely fed that narrative. Focus now on FOMC meeting. Any hint of a downshift could spark a further re-rating lower in yields, which will be supportive of spreads in the short-term.

Brad Bechtel—The Fed has underpinned the USD with rising real rates, but that has not been the whole story. The USD benefits on two sides of the USD smile, one is US outperforming, like we see currently, and the other is that the US is a safe haven.

Coming into this week, retail investors have been buyers of FAANGMT



Source: Vanda Research; Jefferies

JefMacro

The JefMacro Weekly is the accumulation of this week's best Macro research.

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^Prior trading day closing price unless otherwise noted.

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