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Weekly Commentary

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Crazy, but good year for liquidity

What a difference three-fourths of a year can make. It is hard to believe that the fed funds range was at the zero-bound not just 12 months, but about nine months ago. The Federal Reserve waited too long to act on rising inflation and didn't hike rates until March. Since then, it has been a romp, with policymakers in December pushing rates to a range of 4.25-4.50%. In real terms, that's still negative, but inflation may have peaked. Last week, the Commerce Dept. said that the Personal Consumption Expenditures index increased an annualized 5.5% in November, with core PCE higher by 4.7%. While still too high, the numbers are down compared to the annual rate in October of 6.1% and 5%, respectively. These fit nicely with other recent softening inflation data.

It looks like the Fed made the right call at its mid-December policy-setting meeting when it opted to raise rates by 50 basis points after a series of 75 basis-point hikes. But the Summary of Economic Projections suggests we aren't going to see a pivot in policy any time soon. Participants expect a terminal rate in the 5-5.25% range at the end of 2023 and a serious economic slowdown.

It's also hard to imagine 2023 can bring a more volatile year, but one never knows. For now, we should be thankful for an excellent year for liquidity investors across most industry products as yields traced the Fed moves.

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