Fed Offers Welcome Relief to the Short End

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At the conclusion of the June FOMC meeting this afternoon, Fed officials announced no change in the overnight target rate and that they will continue purchasing $120 billion in assets monthly until further notice. However, they made two important technical adjustments that will effectively nudge short yields off zero to address the supply-demand imbalance in the bond market.

The feared "taper tantrum v2" *did not materialize* as Chairman Powell and Fed officials *will wait until further progress has been made before even considering a reduction in QE purchases*. In his post-meeting press conference, Powell said the Fed would give advance notice of any taper plans and added that data would determine the timing of any changes.

The Fed's technical adjustments included an increase in the overnight reverse repo rate from 0.00% to 0.05%, and an increase in interest (paid) on excess reserves (IOER) from 0.10% to 0.15%. The IOER hike incentivizes banks to hold higher balances with the Fed, thereby easing overall demand for short securities. The reverse repo facility allows eligible financial firms to make collateralized overnight loans to the Fed. With few available options, broker-dealers and money funds have used this program to invest hundreds of billions daily at 0.00%. The reverse repo rate adjustment, similar to the IOER increase, drags the entire front end higher.

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The much-anticipated updated "dot plot" showed Fed officials expect initial rate hikes much sooner than previously expected. The number of committee members forecasting at least one increase in the overnight funds rate next year climbed from four to seven. Thirteen of 18 Fed officials now envision at least one hike in 2023, up from seven at the March meeting. Of these 13 members, seven see at least two hikes in 2023. Powell cautioned that these rate projections do not represent a plan or a consensus.

Powell continues to view inflationary pressure as "transitory," but said the FOMC will be prepared to adjust policy if inflation moves materially above committee goals. Powell said the U.S. is on a path to a very strong labor market in one or two years. These are both fairly hawkish statements that the financial markets seem to have taken in reasonable stride.

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The bond market has sold off across the curve this afternoon. Short yields climbed off record lows, with the 12-month Treasury bill at 0.075%, the highest yield in more than three months, and the two-year above 0.20% for the first time in a year. Although long yields have also retreated, investors seem to believe Powell's comment that the committee will provide ample advance notice of any tapering move, and when tapering begins, it will likely be gradual. The 10-year Treasury-note yield is currently up 8 bps on the day to 1.57%, matching the close from seven business days ago.

Stocks gagged when the more aggressive dot plot and the two technical adjustments were announced, but settled down after hearing Powell walk carefully through the outlook. At one point, the DOW was down more than 380 points, but recovered more than 117 of the loss to close down 265 points on the day. The Nasdaq, down 170 points early this afternoon, climbed into positive territory before sliding late to close down 33 points. Say what you will about Powell, but once again he's managed to assure investors of a competent and credible Fed.

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Market Indications as of 3:44 P.M. Central Time

DOW	Down -266 to 34,034 (HIGH: 34,778)
NASDAQ	Down -33 to 14,040 (HIGH: 14,174)
S&P 500	Down -23 to 4,224 (HIGH: 4,255)
1-Yr T-bill	current yield 0.07%; opening yield 0.06%
2-Yr T-note	current yield 0.21%; opening yield 0.17%
3-Yr T-note	current yield 0.41%; opening yield 0.34%
5-Yr T-note	current yield 0.90%; opening yield 0.78%
10-Yr T-note	current yield 1.58%; opening yield 1.49%
30-Yr T-bond	current yield 2.21%; opening yield 2.19%