



INSIGHTS

Can the Fed Have Its Cake and Eat It Too?

A Reference Guide for Top of Mind with SIFMA Insights

March 2023

Key Takeaways

This is a Reference Guide to accompany the Top of Mind with SIFMA Insights [podcast](#), “Can the Fed Have Its Cake and Eat It Too?” Inside, we define terms and provide charts for topics we discuss including:

- **Fed Funds Rate:** Currently 4.75%-5.00%. Interest rate at which banks lend money to each other, typically on an overnight basis. Raising the target rate reduces the money supply and causes other market rates to rise, dampening consumer and business spending, slowing economic activity, and reducing inflation.
- **Inflation:** Currently, CPI 6.0%/Core CPI 5.5%/PCE 5.4%/Core PCE 4.7%. Reflected quantitatively by an increase of an average price level of a basket of selected goods and services in an economy and represents the rate of decline of purchasing power of a given currency over some period of time.
- **Unemployment:** Currently 3.6%. Represents the number of unemployed people as a percentage of the labor force, which is the sum of the employed and unemployed.

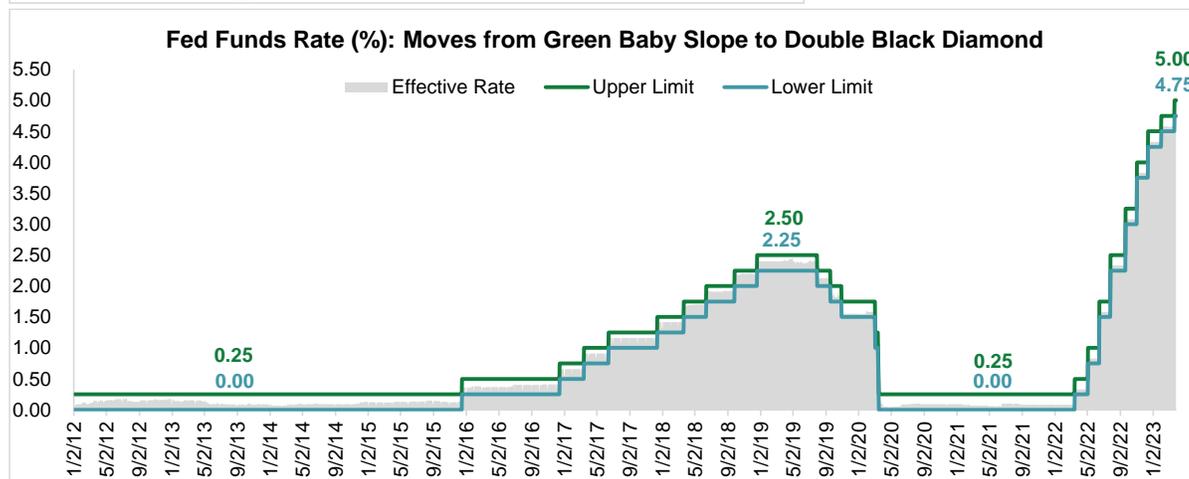
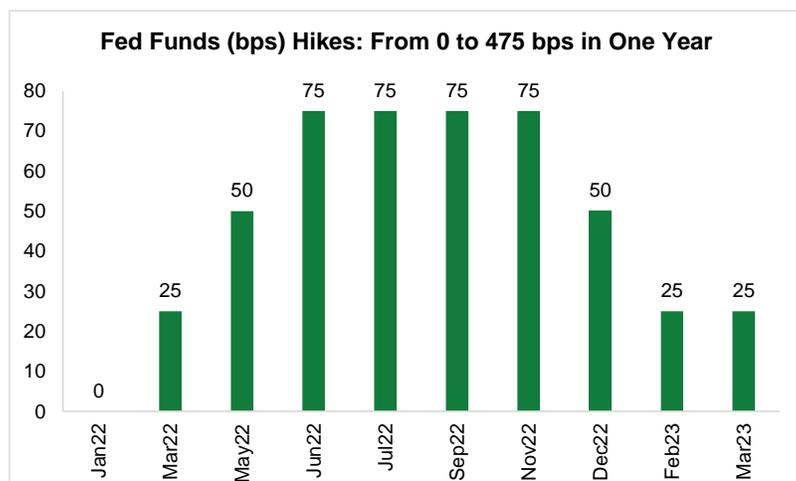
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Top of Mind Reference Guide: Can the Fed Have Its Cake and Eat It Too?

Federal Funds Rate (Fed Funds): *The interest rate at which banks and other depository institutions lend money to each other, typically on an overnight basis.*

The Fed uses open market operations, a monetary policy tool, to buy and sell U.S. Treasury securities on the open market to align the actual Fed Funds rate with the Federal Open Market Committee's (FOMC) target rate.

To lower its target rate, the trading desk at the Federal Reserve Bank of New York (FRBNY) buys securities to increase the supply of reserves held by banks, paid for by crediting these banks' reserve accounts. The banks can use those reserves to convert into loans, adding to the money supply and putting downward pressure on the Fed Funds rate. Short and long-term market interest rates directly or indirectly linked to the Fed Funds rate also tend to fall, encouraging consumer and business spending, stimulating economic activity, and increasing inflationary pressures. Conversely, to raise the FOMC's target rate, the FRBNY trading desk sells Treasuries, collecting payments from banks by withdrawing funds from their reserve accounts. This reduces the money supply and puts upward pressure on the Fed Funds rate. Other market rates then rise, dampening consumer and business spending and, therefore, slowing economic activity and reducing inflationary pressures.

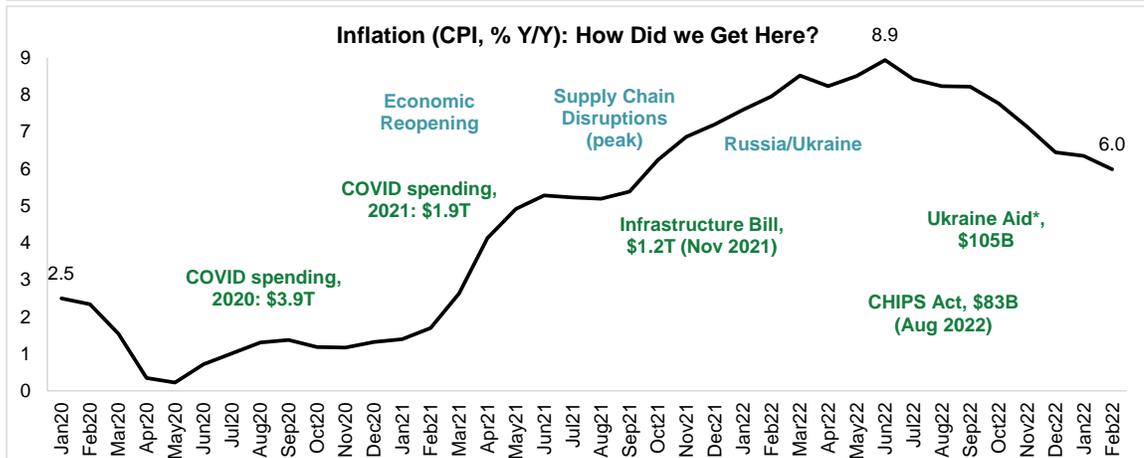
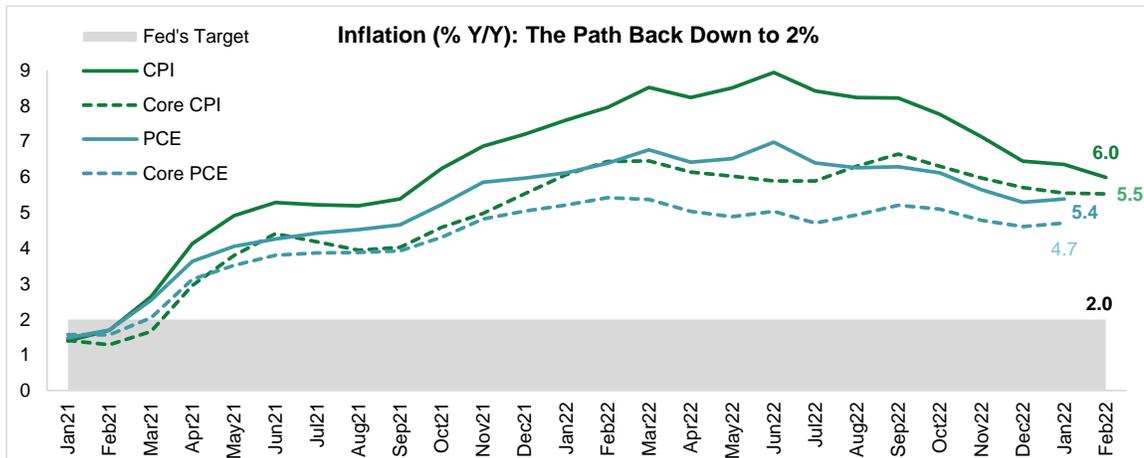


Inflation: An increase of an average price level of a basket of selected goods and services in an economy, representing the rate of decline of purchasing power for a given currency over some period of time.

There are multiple components of the inflation equation, with pressure points bucketed as: supply side, demand side, and the labor component. Common measures of inflation are:

- **CPI** – headline inflation; measures the change in direct expenditures for all urban households for a defined basket of goods and services (three largest components are housing, transportation, and food/beverages)
- **PCE** – the metric the Fed monitors for monetary policy – measures the change in the prices of goods and services consumed by all households and nonprofit institutions serving households
- **Core CPI or PCE** – makes adjustments to remove the source of the noise in the price data, i.e. food and energy, to get a measure of the underlying component of inflation

There are several differences between each measure. For example, basket composition for CPI is based on household purchases (includes imports) whereas PCE is based on what businesses are selling (includes capital goods). Other differences include calculation methodologies, accounting for basket changes, etc.

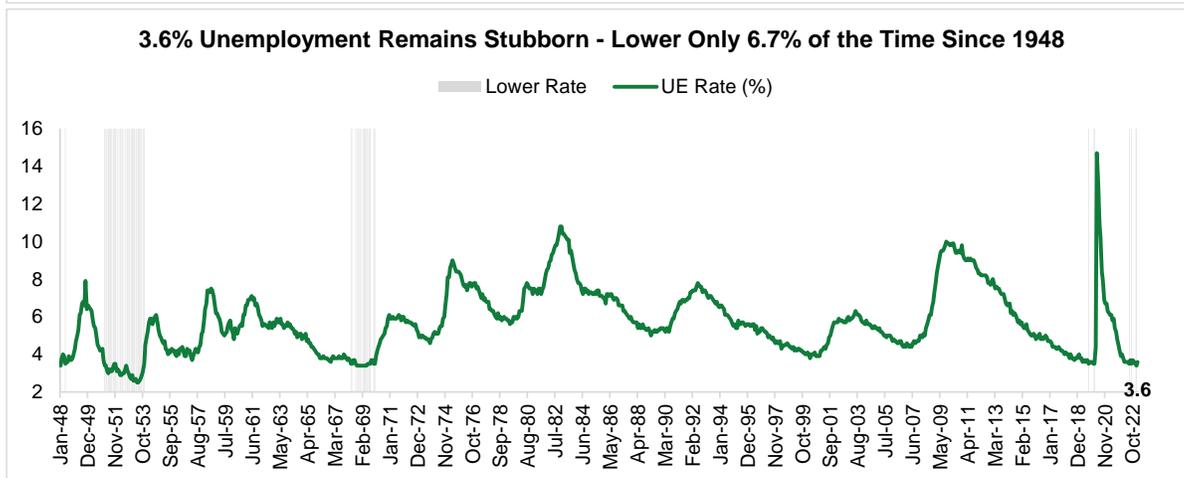
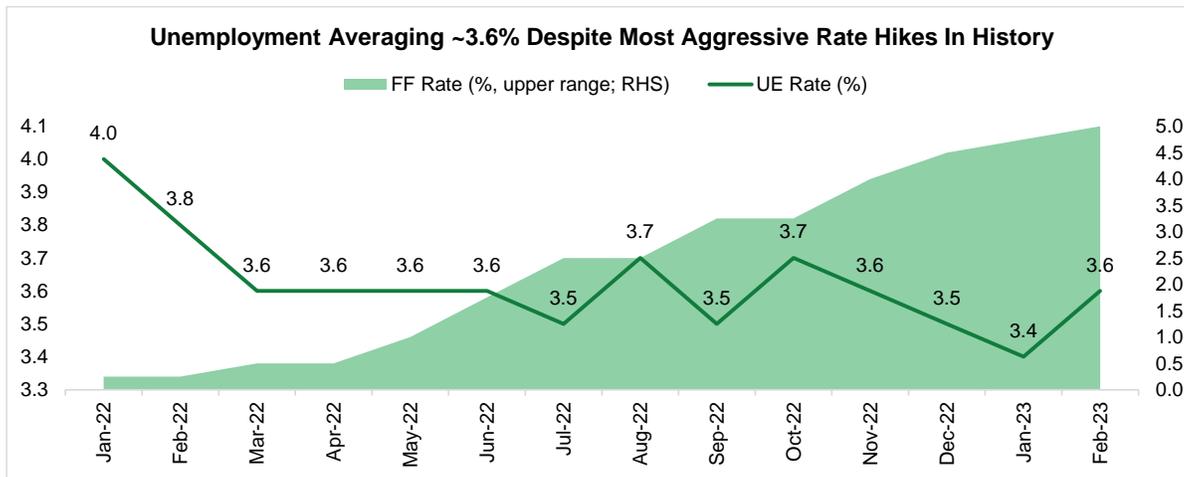


Source: FRED, IMF, SIFMA estimates (CPI/Core CPI as of February, PCE/Core PCE as of January; Ukraine Aid as of November 2022)

Unemployment: *The number of unemployed people as a percentage of the labor force, which is the sum of the employed and unemployed: $(Unemployed \div Labor\ Force) \times 100$.*

According to the Bureau of Labor Statistics Current Population Survey, people are classified as not in the labor force if: (a) they were not employed during the survey reference week; and (b) they had not actively looked for work (or been on temporary layoff) in the last 4 weeks. People not in the labor force are those who do not meet the criteria to be classified as either employed or unemployed as defined above and can be classified into several subgroups: (a) people who want a job now; (b) people marginally attached to the labor force (not in the labor force but currently want a job); and (c) discouraged workers (not actively searched for work in the last four weeks).

This measure of unemployment is called the U-3 rate and is the most commonly reported. However, many argue it underestimates the true level of unemployment. Some prefer the U-6, as it is the broadest measure of labor underutilization. In addition to the total number of unemployed and all people marginally attached to the labor force, U-6 includes people at work part time for economic reasons, or involuntary part-time workers.



Source: Bloomberg, SIFMA estimates

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