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FOMC: Terminal arrival?

Key takeaways

- The FOMC announced a further increase to the Fed Funds Rate by 25-basis points. The Committee readjusted its statement and removed prior language that suggested further hikes were possible.
- Market response was muted with equity markets remaining in positive territory before selling off towards the end of Powell's press conference. Fed Funds Futures continued to price in rate cuts by the end of the year.
- Chairman Powell attempted to deliver a balance between hinting the end of monetary tightening whilst noting further possible rate hikes if the data demands it.

1. What happened?

Today the FOMC announced a further increase to the Fed Funds Rate by 25-basis points, moving the target range to 5.00% – 5.25%. The Fed Funds Rate is now at its highest level since 2007, following its 10th consecutive rate increase.

The Fed's statement further reinforced the economic landscape across the United States, confirming that activity had expanded "at a modest pace" whilst continuing to highlight the robustness of the labor market. The statement kept previous comments that focused on the resilience of banking sector but noted that the tightening of financial conditions since March will "continue to weigh on economic activity".

The key changes made were around the potential for further rate hikes. The previously stated expectation of "additional policy firming" being needed was completely removed. The committee noted that in "determining the extent that additional policy firming may be appropriate", the FOMC would assess the lagging impact that previous hikes have had on economic activity. The Fed statement also reiterated its goal of reducing the size of the central banks balance sheet.

Chairman Jerome Powell begun the press conference by addressing the recent activity within the regional banking sector, reaffirming that the wider banking system was "resilient" and that conditions had improved since early March. Whilst the labor market remains very tight, Powell acknowledged that there are now "some signs" of a "better balance" between supply and demand. Powell confirmed that the committee remained "prepared to do more" if needed but will be on a meeting-by-meeting basis.

When asked about the change in statement language, Powell said such a change was indeed "meaningful" but confirmed that any specific decision around a possible pause would only be made at the next meeting in June. Discussing the growing concerns around the debt ceiling, Powell reiterated that it was "essential" that it be raised in a "timely way".

2. How did markets react?

The market reaction to the latest FOMC decision appeared to be quite muted with equity markets remaining close to levels seen prior to the beginning of the press conference as investors fully priced in the expected 25-basis point hike.

There however appeared to be some selling pressure towards the end of Powell's press conference as the Chairman was pressed on whether rate cuts were on the horizon, to which he believed they were not as inflation levels still remained high.

3. What does it mean for investors?

Today's FOMC decision and subsequent statement is the clearest signal that the most aggressive monetary policy period since the 1980s is coming to an end. The latest rate hike appears to be the last before the Federal Reserve hold at current levels for the remainder of 2023.

Given the nature of previous press conferences and other statements, Chairman Powell was eager to remind his audience that the FOMC will remain data dependent around the various measures, although he did acknowledge the committee had "possibly" reached a suitably restrictive level for the Fed Funds Rate in order to rein-in inflation further.

Such data points are indeed moving in the right direction. With 500-basis points of rate hikes over the past 14 months, CPI has fallen to 5% on an annualized basis whilst the labor market has begun to show signs of weakness both in terms of softening payroll numbers as well as overall job vacancies available to the workforce.

Considering the recent concerns surrounding the regional banking sector, one data point that will certainly grow in prominence in the eyes of the Fed will be credit conditions and how tighter lending will affect both business activity and labor markets over the coming months.

Overall, for Chairman Powell to suggest that the FOMC was even *possibly* done with its tightening cycle is a strong indicator that the next phase of the Federal Reserves monetary policy is set to begin. Dismissing again the idea of rate cuts in 2023, markets should adjust to the imminent arrival of the long-awaited pause.

Changes in the latest FOMC statement implies that the Federal Reserve have finally reached the terminal rate and are ready to hold rates at current levels. However, given the data dependency of the committee, Chairman Powell kept the door partly open for another rate increase if needed. One thing that is not being considered however, is rate cuts, which may upset markets over the short-term.

Glossary

The consumer price index (CPI) measures the price of a basket of products and services that is based on the typical consumption of a private household.

The Fed funds rate is the interest rate at which depository institutions lend overnight to other depository institutions.

The Federal Reserve (Fed) is the central bank of the United States. Its Federal Open Market Committee (FOMC) meets to determine interest rate policy.

The NASDAQ index is a market-capitalization weighted index of around 3,000 equities listed on the Nasdaq exchange.

The S&P 500 Index includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Treasuries are bonds issued by the U.S. government.

USD is the currency code for the U.S. Dollar.

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