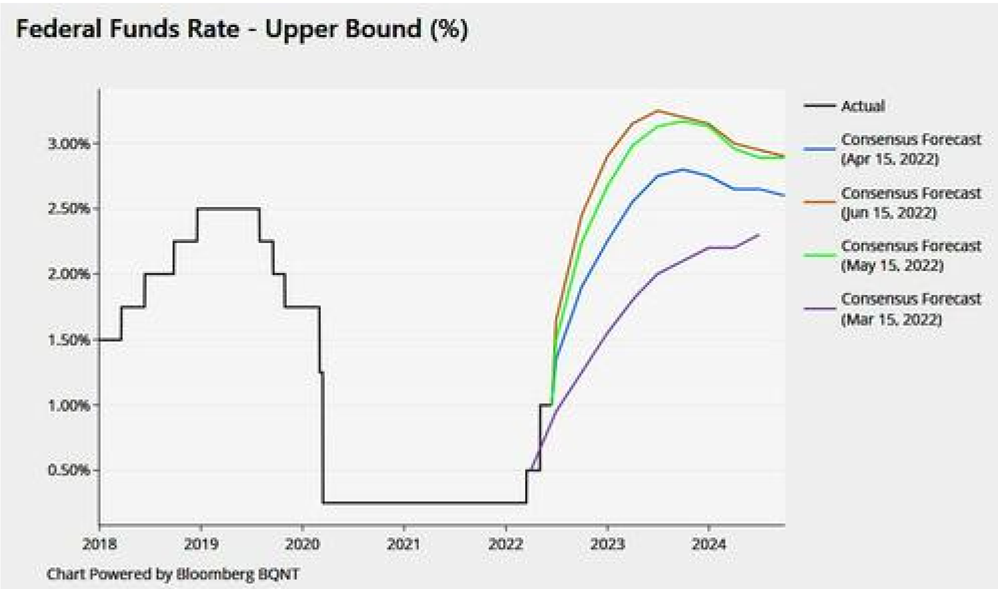
Fed Hikes Rates By The Most In 28 Years, Signals Volcker-Era Is Back

Description

Tl;dr: The Fed **hiked rates by a stunning (but expected) 75bps** – the biggest hike since 1994. **Esther George dissented** (preferring 50bps). Fed expresses that is **“strongly committed” to fighting inflation**.

The Fed sharply raised its rates outlook (to meet market expectations) and **sharply lowered its growth and employment outlooks.**



The last time the Fed hiked 75bps, we got the ‘Tequila Crisis’ and The IMF had to bail out Mexico.

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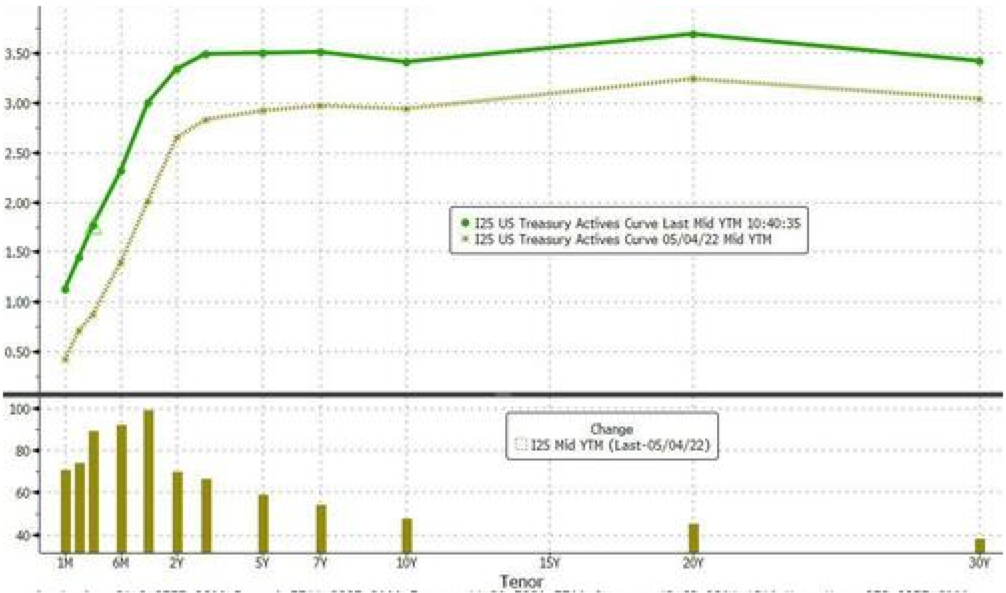
Since the last FOMC statement on May 4th, all hell has broken loose in global capital markets (and economies).

US equities have collapsed (Nasdaq -15%) and US Treasury yields have exploded higher. Gold is down around 3% since the last FOMC, mirroring the 3% or so gain the USDollar Index…(NOTE everything shifted after last Friday's CPI)

Source: Bloomberg

The ugliness in bond-land was led by the short-end (with 2Y yields up almost 60bps since the last FOMC and 30Y yields up 40bps)…



Source: Bloomberg

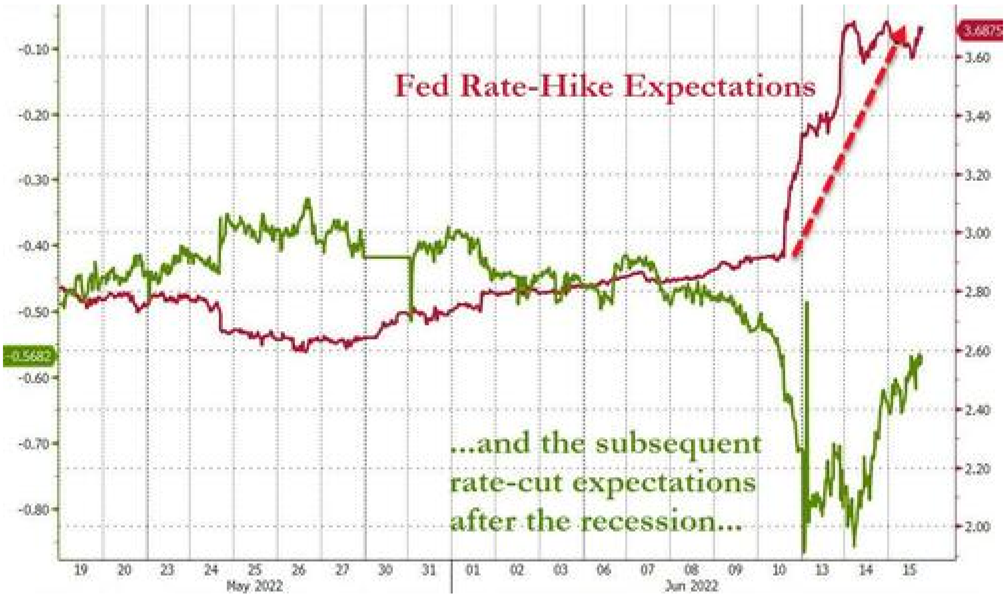
…pushing the yield curve back into inversion once again…

Source: Bloomberg

While the last FOMC statement crowed of the underlying strength of the US economy, macro data has dramatically and serially disappointed in the month or so since…

Source: Bloomberg

Rate-hike expectations overall have soared higher since the last FOMC statement, mostly driven in the last week post-CPI…

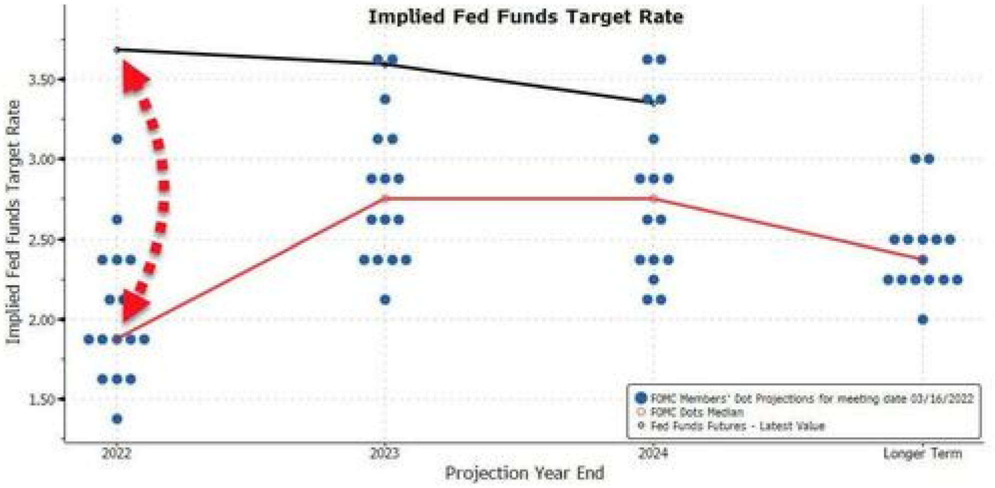


Source: Bloomberg

With the market now pricing in 100% odds of 75bps today and in July, and 40% chance of 75bps in September too

Source: Bloomberg

Today will also see the release of new forecasts by Fed members. The current market expectations are dramatically above The Fed’s last dot-plot, so we expect significant changes…



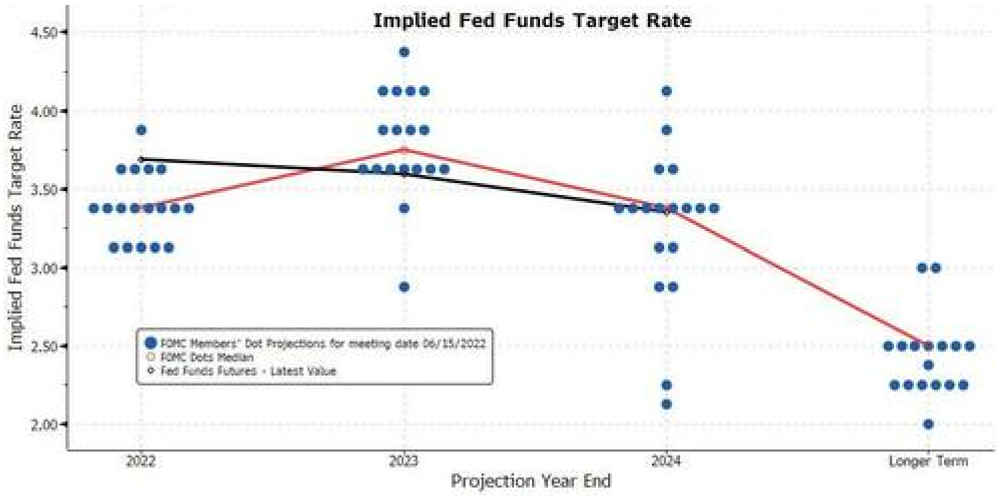
Source: Bloomberg

Here's what The Fed did:

- **The Fed raised its benchmark rate by 75 basis points — the biggest increase since 1994** — to a range of 1.5%-1.75%, in line with investors' and economists' expectations
- Kansas City Fed President **Esther George dissented** in favor of a 50 basis-point hike
- **FOMC adds a line saying it's "strongly committed to returning inflation to its 2% objective"** and removes prior language that said the FOMC "expects inflation to return to its 2% objective and the labor market to remain strong"
- **Reiterates path on balance-sheet reduction** that took effect June 1, shrinking bond portfolio by $47.5 billion a month and stepping up to $95 billion in September

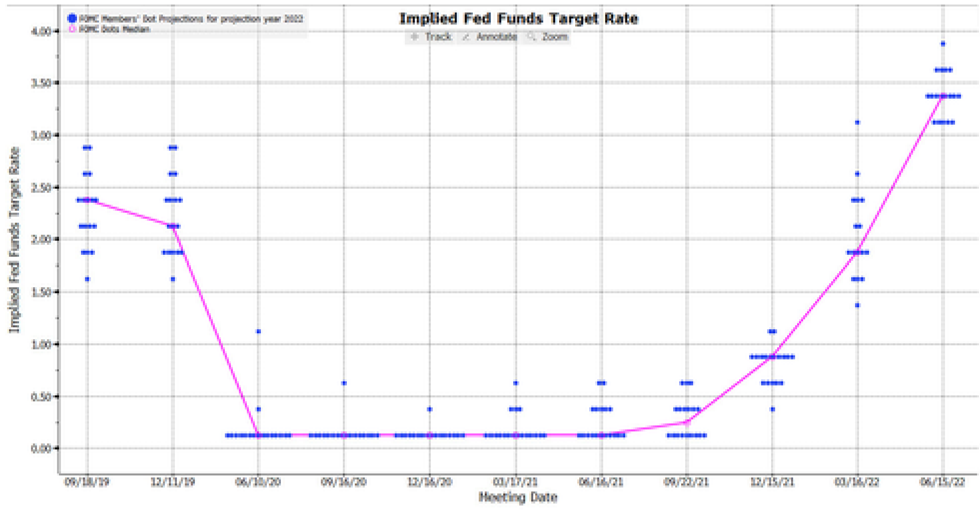
The Fed shifted its dots up to the market…

New dot-plot projections showed sharp increase from March, with federal funds target rising to 3.4% by year-end – **implying another 175 basis points of tightening this year** – and 3.8% in 2023, before falling to 3.4% in 2024; prior forecasts in March were for a 1.9% rate this year and 2.8% in 2023 and 2024



One crucial thing to note in the new dot-plot is that **2024 will be a year of dramatic uncertainty** (and not just because of the election) with Fed members expectations ranging from a minimum of 2.0% and maximum of 4.0% – the biggest spread in FOMC history.

From “transitory” to “panic”?



Additionally, **The Fed’s economic projections showed a much bumpier soft landing expected,** with the unemployment rate rising from 3.7% at end-2022 to 4.1% in 2024; growth forecasts were cut to 1.7% in 2022 and 2023, from 2.8% and 2.2% in March; Fed officials still expect inflation to come down significantly in 2023

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2022

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2022	2023	2024	Longer run	2022	2023	2024	Longer run	2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8	1.5–1.9	1.3–2.0	1.5–2.0	1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2	1.6–2.2
March projection	2.8	2.2	2.0	1.8	2.5–3.0	2.1–2.5	1.8–2.0	1.8–2.0	2.1–3.3	2.0–2.9	1.5–2.5	1.6–2.2
Unemployment rate	3.7	3.9	4.1	4.0	3.6–3.8	3.8–4.1	3.9–4.1	3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.5	3.5–4.3
March projection	3.5	3.5	3.6	4.0	3.4–3.6	3.3–3.6	3.2–3.7	3.5–4.2	3.1–4.0	3.1–4.0	3.1–4.0	3.5–4.3
PCE inflation	5.2	2.6	2.2	2.0	5.0–5.3	2.4–3.0	2.0–2.5	2.0	4.8–6.2	2.5–4.0	2.0–3.0	2.0
March projection	4.3	2.7	2.3	2.0	4.1–4.7	2.3–3.0	2.1–2.4	2.0	3.7–5.5	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	4.3	2.7	2.3		4.2–4.5	2.5–3.2	2.1–2.5		4.1–5.0	2.5–3.5	2.0–2.8	
March projection	4.1	2.6	2.3		3.9–4.4	2.4–3.0	2.1–2.4		3.6–4.5	2.1–3.5	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	3.4	3.8	3.4	2.5	3.1–3.6	3.6–4.1	2.9–3.6	2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1	2.0–3.0
March projection	1.9	2.8	2.8	2.4	1.6–2.4	2.4–3.1	2.4–3.4	2.3–2.5	1.4–3.1	2.1–3.6	2.1–3.6	2.0–3.0

* * *

Full Redline below:

~~Although overall~~Overall economic activity ~~edged~~appears to have picked up after edging down in the first quarter~~, household spending and business fixed investment remained strong.~~. Job gains have been robust in recent months, and the unemployment rate has ~~declined substantially~~remained low. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures.

The invasion of Ukraine by Russia is causing tremendous human and economic hardship. ~~The implications for the U.S. economy are highly uncertain.~~ The invasion and related events are creating additional upward pressure on inflation and are ~~likely to weigh~~weighing on global economic activity. In addition, COVID-related lockdowns in China are likely to exacerbate supply chain disruptions. The Committee is highly attentive to inflation risks.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. ~~With appropriate firming in the stance of monetary policy, the Committee expects inflation to return to its 2 percent objective and the labor market to remain strong.~~ In support of these goals, the Committee decided to raise the target range for the federal funds rate to ~~3/4~~1-1/2 to 1-3/4 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee ~~decided to begin~~will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities ~~on June 1~~, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in ~~conjunction with this statement~~May. The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the ~~Committee's~~Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on public health, labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michelle W. Bowman; Lael Brainard; James Bullard; ~~Esther L. George~~Lisa D. Cook; Patrick Harker; Philip N. Jefferson; Loretta J. Mester; and Christopher J. Waller. Voting against this action was Esther L. George, who preferred at this meeting to raise the target range for the federal funds rate by 0.5 percentage point to 1-1/4 percent to 1-1/2 percent. Patrick Harker voted as an alternate member at this meeting.

by Tyler Durden

Category

1. Economy-Business-Fin/Invest
2. Main

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