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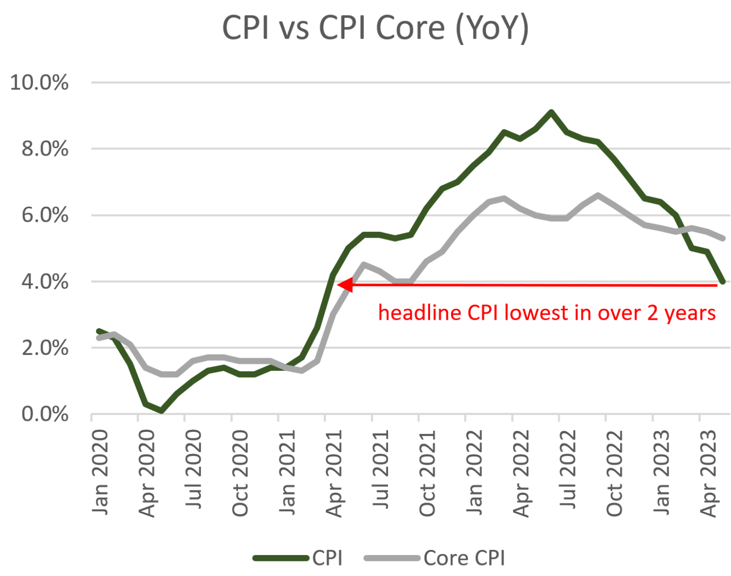
MARKET UPDATE

Time for a break.

The Fed delivered the expected ‘hawkish pause’ yesterday, keeping rates unchanged this month after hiking rates at each of its 10 prior meetings. But the committee does not believe the job is done, with the majority of members expecting at least two more rate increases this year if the economy and inflation do not cool significantly. This would put the upper bound of fed funds at 5.75%, the highest level since 2000.

The Fed is walking a tightrope, trying to balance the risk of overtightening with the risk of pivoting too early and allowing inflation to come roaring back. Powell acknowledged as much, saying “We’ve covered a lot of ground, and the full effects of our tightening have yet to be felt,” while also stating “The process of getting inflation down is going to be a gradual one.”

With core CPI running at over 5.0%, Powell seems to believe further increases may be coming as soon as next month. “We’re trying to get this right, and if you think of [the speed and the level of rate increases] as separate variables, then I think that the ‘skip’—I shouldn’t call it a ‘skip’—the decision makes sense,” Powell said. We think he slipped up and said what he was actually thinking on this one. And to avoid any confusion, Powell added that any rate cuts would be “a couple years out”.



Source for Chart: Bloomberg

The market has not completely bought into the Fed’s narrative, with many economists believing the threat of future inflation may be somewhat less severe than the central bank indicates. They predict that inflation will likely be lower than projected by year-end and ultimately expect the Fed to implement fewer rate hikes than indicated by the new dot plot. This is reflected in the in the forward curve, with traders pricing in only a 78% chance of one additional hike in September followed by rates cuts beginning next year.

Datapoint	June EOY 2023 Projection	March EOY 2023 Projection	Change	Takeaway
Change in real GDP	1.0%	0.4%	+0.6%	**Impacts of tightening monetary policy have lagged** more than anticipated and the labor market has proven to be resilient.
Unemployment Rate	4.1%	4.5%	-0.4%	**Jobs data remains strong**, despite an uptick in the May unemployment rate.
Core PCE inflation	3.9%	3.6%	+0.3%	**Inflation is proving to be stickier** than the FOMC anticipated.
Fed Funds Rate	5.6%	5.1%	+0.5%	Stronger than anticipated GDP and labor market data in combination with inflation continuing to run above target suggests that **the fed fund rate may need to be higher by year-end.**

Have questions about your next cap or anything else in this update? Give us a call at 980.208.1600 or email info@bascomadvisors.com.