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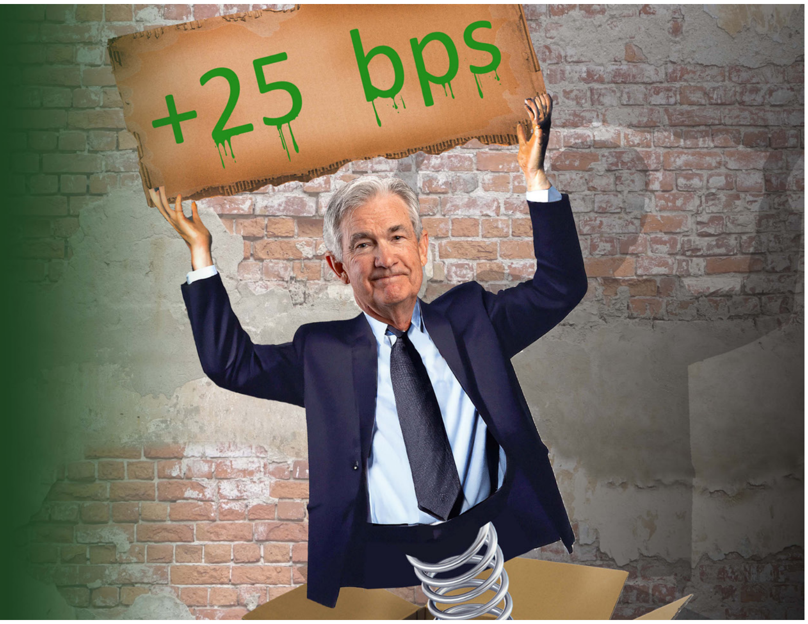
Market Update

July 2023 FOMC



Surprise, surprise, the Fed elected to hike rates 25bps today, in line with the market's expectations. This marks the 11th hike this cycle and brings the upper bound of fed funds to 5.50%, the highest level in 22 years. Despite inflation cooling, the Fed has not seen a meaningful slowdown in hiring or economic growth that is generally associated with the tighter financial conditions needed to keep inflation moving towards the 2.0% long-term target. The majority of FOMC members probably think that at least one more hike is needed to reach a sufficiently restrictive stance, but they likely feel less strongly about that forecast than they did in June.

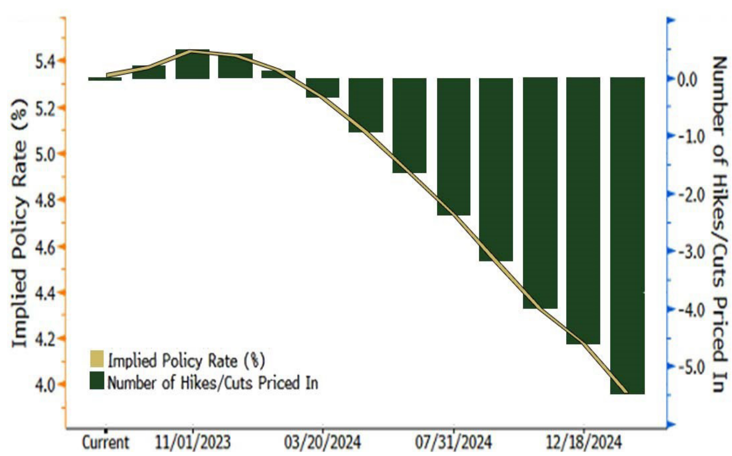
From the Fed's statement following the hike, "Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated." That certainly doesn't sound like the language that would precede a pivot on monetary policy.

Notably, the statement refers to, "the extent of additional policy firming that may be appropriate", which is more hawkish than the language used in May, which said, "the extent to which additional policy firming may be appropriate."

As Fed governor Christopher Waller said following the headline CPI print at 3.0% this month, the data "warmed my heart, but…I've got to make policy with my head. And I can't do that on one data point." The Fed does not want to cut too soon and have inflation spike back up…i.e., the Committee doesn't want to repeat the mistakes made by Volker in the early 80's.

We did not receive updated projections from the Committee at this meeting, but investors were paying close attention to Powell's press conference following the announcement. The chairman reiterated the Fed remains data dependent moving forward, saying this isn't the environment for "a lot of forward guidance" and "we are going to make a decision at the next meeting" and then the one after that. Regarding inflation, Powell said the policy rate has not been "restrictive enough for long enough" to do the job. And there is still "a long way to go."

Traders are not completely buying into the Fed's narrative, **with futures currently pricing in only a 47% chance of another hike in November**, followed by over four rate cuts next year. The market knows the power of "Fed speak"…the Fed may not truly believe that it will need to raise rates again this cycle, but they have no reason to announce that now. The market would react by pricing in additional cuts, which would loosen financial conditions and compound the Fed's dilemma.



Source for Chart: Bloomberg

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