May 5, 2022

For the US Fed, 50 is the new 25

Yesterday evening, the Fed announced its biggest rate hike since 2000; a 50bp increase, bringing the target range to 0.75%-1% as it works to get US inflation under control. After a 25bp hike in March, the US central bank's policy-setting Federal Open Market Committee (FOMC) delivered its first back-to-back increase since 2006 and confirmed more increases "will be appropriate."

The 50bp hike was well expected by markets and since the bar for the Fed to surprise the market on the hawkish side was already set very high, the market reaction was positive for risky assets. Going into the meeting, some market participants and Fed member(s) deemed a 75bp hike necessary but Powell commented that a such a large increase was not something the FOMC was actively considering.

In an unusual move, Powell opened his news conference speaking to the American people:

"Inflation is much too high. And we understand the hardship that is causing," he said, promising to use all tools available to bring it down "expeditiously". He acknowledged that higher interest rates also bring their share of pain, but "everyone would be better off if we can get this job done. The sooner, the better." To achieve that aim, he said "additional 50-basis point increases should be on the table at the next couple of meetings, however, a more aggressive three-quarter point hike is not under consideration."

The FOMC also announced that quantitative tightening (QT) will begin on June 1st. This process involves allowing maturities to run off the Fed's balance sheet, subject to a monthly cap. The cap for the monthly reduction in holdings in US Treasuries will be set at USD 30bn for the first three months, before increasing to USD 60bn per month. For MBS (mortgage-backed securities) the cap will be set at USD 17.5bn per month, rising to USD 35bn after three months. So, once it reaches "cruising speed", the Fed will reduce its balance sheet by USD 95bn per month.

Powell emphasized that the US economy was strong, the labour market extremely tight and inflation too high. The FOMC acknowledged the "highly uncertain" impact of the conflict in Ukraine and sanctions on Russia which are "creating additional upward pressure on inflation and are likely to weigh on economic activity." In addition, it was commented that Covid lockdowns in China "are likely to exacerbate supply chain disruptions".

Following the announcement, the S&P 500 jumped 3%, bond yields came down slightly and the USD lost some terrain vs the euro and other majors, all signaling relief on the market that the Fed did not "over deliver".

The next FOMC meeting is planned for June 15th, at which another 50bp hike is expected.

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