UBS

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The Fed continues to hike rates

UBS Asset Management l The Fed remains committed to bringing inflation down

The Fed raised rates by 75 basis points for the fourth consecutive meeting

The Federal Open Market Committee (FOMC) of the US Federal Reserve hiked rates at their 2nd November meeting by 75 bps, moving the fed funds target range to 375 bps – 400 bps from 300 bps – 325 bps. The move continues to reflect a FOMC that remains highly focused on reigning in inflationary pressures. The vote for the rate hike was once again unanimous at 12-0.

The meeting statement contained some pretty significant changes relative to the September statement. In particular, ongoing increases in the target range for fed funds will be done "in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time." This differed from the prior meeting statement whereby ongoing rate increases would merely be "appropriate." However, what got the market's attention was further language in the statement noting that the pace of future rate increases "will take into account the cumulative tightening of monetary policy, the lags which monetary policy affects economic activity and inflation, and economic and financial developments." In other words, the FOMC would consider the impact of previous hikes on economic conditions, acknowledging that there is a lag effect for how quickly those rate increases impact the economy. This is noteworthy given the Fed has accelerated the pace of their tightening of late to 75bps per meeting relative to the more usual 25 bps seen in recent tightening cycles.

However, as much as risk markets initially cheered the inclusion of this language about the lagged effects of monetary policy as perhaps pointing to a FOMC that may be seen nearing the peak of the tightening cycle, Fed Chair Powell threw cold water on that notion during his press conference. Chair Powell signalled that the Fed still "has some ways to go" to reach the "sufficiently restrictive" level of the fed funds target rate. He also mentioned that the terminal rate is likely going to be higher than what was implied by the 2023 median dot from the September dot plot of fed funds expectations. Adding to the hawkish narrative, Chair Powell also said that the risk of doing too little policy tightening outweighs the risk of doing too much. He mentioned that if the FOMC were to overtighten, they could "use our tools strongly to support the economy," but if inflation isn't brought under control then there's a risk it becomes entrenched and "employment costs, in particular, will be much higher potentially." Finally, addressing any speculation of a Fed pause, he said that it's "very premature" to be thinking about pausing rate increases.

In summary, while the FOMC seemingly laid the groundwork for a potential slowdown in the pace of rate increases at the December meeting to 50 bps, based on Chair Powell's comments in his press conference, the peak terminal rate may occur at a higher level and later in 2023 than what was previously anticipated by the market before the meeting. Fed funds futures ended the day pricing in 57 bps worth of hikes for the next FOMC meeting in December with a peak rate of 5.08% for both the May and June 2023 FOMC meeting contracts.

We continue to position our UBS money market funds to take advantage of this rate hike along with future ones.

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