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The Fed continues to raise rates

UBS Asset Management l The Fed acts on inflationary pressure

The Fed raised rates by 75 basis points, the largest single meeting move since 1994

The Federal Open Market Committee (FOMC) of the US Federal Reserve hiked rates at their 15th June meeting by 75 bps, moving the fed funds target range to 150 bps – 175 bps from 75 bps – 100 bps. The move was the largest single meeting increase since 1994 and signals that the FOMC is clearly focused on reigning in inflationary pressures. The vote for the rate hike was 10-1, with only Kansas City President, Esther George, dissenting as she favored only a 50 bp hike.

Only a week before the meeting, the market was expecting a 50 bp hike from the Fed at this meeting. However that outlook changed on June 10th with the release of the May US CPI report. Monthly headline CPI came in at +1.0% relative to expectations of a 0.7%, which pushed the year-over-year reading to +8.6% relative to expectations of an +8.3% increase. That report coupled with a Wall Street Journal article on Monday suggesting the FOMC may be contemplating a 75 bp hike caused the market to re-price expectations accordingly.

One of the notable tweaks in the statement relative to the last meeting was that the FOMC chose to use more forceful language around their inflation objective, saying that it is "strongly committed" to returning inflation to its 2% target. The FOMC also released their latest quarterly Summary of Economic Projections (SEP). On the inflation front, the median expectation of the Committee is for headline inflation to slow to +5.2% by year's end, and to +2.6% by the end of next year. They see the unemployment rate going from 3.6% currently to 3.7% at the end of this year, and to 4.1% at the end of 2024. Expectations about the future path of the federal funds rate now show a median expectation of 3.4% by the end of this year, with a higher rate by the end of next year at 3.8%, before declining to 3.4% by the end of 2024. The change of the median dot for the end of this year over just the past two summary of economic projections (SEP) releases has been truly remarkable, going from 0.9% at the December meeting, to 1.9% at the March meeting, to now 3.4%.

The FOMC also elected not to make any changes to where the reverse repo program rate (RRP) and interest on excess reserves (IOER) are set within the targeted band for the federal funds rate. There was some speculation in the market the FOMC may make a tweak to these administered rates given that the Secured Overnight Financing Rate (SOFR) has been trading of late well below not only the RRP rate, but also over the past two days, the lower bound of the federal funds targeted range. SOFR is a measure of overnight Treasury repo and was calculated at 0.69% on 14th June relative to the RRP at 0.80% and the 0.75% lower bound of the federal funds targeted range. The drop in SOFR hasn't yet pressured the federal funds rate lower (0.83% on 14th June), which may be why the FOMC held off on making any adjustments.

During the press conference, Fed Chair Powell mentioned that the Fed could hike by 50 bps or 75 bps at their next meeting in July depending on the evolution of inflation and the economy. However, he also said that hikes of 75bps wouldn't be "common." In addition to the recent increases in realized inflation data, Powell also highlighted the "eye catching" recent increase in long-term consumer inflation expectations and the importance of not letting that get unhinged. He also acknowledged that consumers likely care more about headline inflation given that is more representative of day to day experience.

Market reaction by the end of the day was a risk-on move in equity markets with the S&P finishing the day up ~1.46%. Treasury yields moved lower by day's end given the FOMC wasn't more hawkish (e.g. hiking by 100 bps) along with Powell's comment that 75 bps hikes weren't expected to be a common occurrence. Two-year Treasury yields finished the day 23 bps lower to 3.20% with the 1yr tenor lower by 11 bps to 2.86%. Fed funds futures finished the day with 195 bps of further hikes for the remainder of the year to 3.55%.

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

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