Powell Talks Tough After Liftoff

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Director
512.481.2012
greg.warner@hilltopsecurities.com

By an 8-1 count, FOMC members voted to hike the overnight fed funds rate by a quarter point. The lone committee member not voting with the majority was St. Louis Fed President James Bullard, who has made no secret of his preference for a larger 50 bps increase. The first rate hike since 2018 was widely expected, *but it won't be the last*. In fact, the updated "dot plot" indicated committee members now anticipate another six before the year is over.

The previous dot plot from last December's meeting showed a yearend overnight target rate of 0.875% compared to the most recent 1.875%. By the end of 2023, committee members now expect the overnight rate will be at 2.75%, up from 1.625% in December. *This shift was more hawkish than analysts had anticipated, but very much in line with market expectations.* Six months ago, the September dot plot was evenly split with half the committee members expecting just a single quarter point hike in 2022 and the other half expecting liftoff wouldn't begin until early 2023.

The first rate hike since 2018 was widely expected, but it won't be the last.

The official statement released after today's meeting didn't mention the coronavirus for the first time in two years. The focus has obviously shifted to inflation, which the statement referred to as "overheating." Later in the press conference, Powell admitted it was likely to take "longer than expected to bring inflation down." The official statement also mentioned the invasion of Ukraine, which has increased uncertainty and is expected to "create additional upward pressure on inflation and weigh on economic activity."

The official statement also mentioned the invasion of Ukraine, which has increased uncertainty and is expected to "create additional upward pressure on inflation and weigh on economic activity."

The Fed's updated economic forecasts showed a drop in the 2022 GDP outlook from +4.0% to +2.8%, while the core inflation outlook was lifted from +2.7% to +4.1%. By the end of 2023, Fed members expect inflation will still be *above target* at +2.7%.

The committee was initially vague about balance sheet reduction, announcing only that it will begin reducing its security holdings at a future meeting. However, in his press conference, Powell said it was *clearly time to begin balance sheet shrinkage*. He went on to say that *excellent progress has already been made* on a plan and that balance sheet contraction will be *faster than last time*. He promised more information in three weeks when the minutes are released.

Powell described the labor market as "extremely tight," a meaningful departure from six months ago when there was "still much work to be done."

Powell described the labor market as "extremely tight," a meaningful departure from six months ago when "there was still much work to be done."

Powell pledged that the committee will take the necessary steps to ensure that inflation does not become entrenched, and still expects price pressures will begin to subside in the second half of the year. He did not discount the possibility of a 50 bp hike in the future, indicating that every meeting would be "live" and data-dependent. In other words, *if inflation doesn't retreat, the Fed will get tougher*.

While stocks whipsawed, Powell said "the Fed would be mindful of the broader context of the financial markets." *It's unclear what this should imply.*

Bond yields are higher on the day, but have retreated a bit since Powell spoke. Stocks plunged after the initial statement, but staged a surprising comeback as the Fed Chairman's words were absorbed. The best explanation for the equity rally is that investors believe the Fed's plan will prove successful. If Powell hoped to gain credibility today, he seems to achieved that much.

Market Indications as of 3:14 P.M. Central Time

DOW	Up 519 to 34,063 (HIGH: 36,800)
NASDAQ	Up 488 to 13,437 (HIGH: 16,057)
S&P 500	Up 92 to 4,355 (HIGH: 4,797)
1-Yr T-bill	current yield 1.25%; opening yield 1.12%
2-Yr T-note	current yield 1.94%; opening yield 1.85%
3-Yr T-note	current yield 2.14%; opening yield 2.04%
5-Yr T-note	current yield 2.17%; opening yield 2.11%
10-Yr T-note	current yield 2.18%; opening yield 2.15%
30-Yr T-bond	current yield 2.44%; opening yield 2.48%