The Fed Agrees; It's 75 with More to Come

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

The bond market decided after a still-too-hot CPI report last Friday that the half point rate hike widely telegraphed by Fed officials wouldn't be enough. Today, the FOMC agreed with the market by announcing the first 75 basis point increase in the fed funds rate in nearly 30 years, boosting the overnight target to a range of 1.50% -1.75%. At the time of the announcement, the larger increase had been entirely priced-in.

The official statement released at the conclusion of the meeting indicated Fed officials were strongly committed to returning inflation to its +2.0% objective, a subtle, but significant shift from the May meeting where inflation *was expected to return to its +2.0% objective*. Today's written statement no longer characterized household spending and business fixed investment as "strong," although the committee did acknowledge that economic activity appears to have improved since the first quarter.

The updated dot plot showed the year-end median overnight funds target had risen sharply from 1.9% to 3.4%. Member forecasts were clustered between 3.25% and 3.75%. In 2023, the median rises to 3.8% before gradually falling in 2024 and 2025. In the near-term, the committee expects "ongoing increases" of three quarters of a point "will be appropriate." Presumably this will include a 75 bp hike on July 27, although it's a probably a fool's errand to predict what happens too far beyond that.

In the near-term, the committee expects "ongoing increases" of three quarters of a point "will be appropriate." Presumably this will include a 75 bp hike on July 27, although it's a probably a fool's errand to predict what happens too far beyond that.

Fed officials boosted their year-end forecast for PCE inflation from +4.3% at the March meeting to +5.2%, with a record 16 members perceiving upside risk in their forecasts. Inflation is expected to retreat to +2.6% by the end of next year.

In the press conference that followed, Powell said:

- Inflation is much too high.
- We really have to achieve price stability.
- The Fed wants to see "progress," before altering its course; needs to see compelling evidence that inflation is coming down.
- Job growth is slowing but still robust. Consumer spending remains strong.
- In response to a question as to why the committee decided on the larger rate hike, Powell said inflation came in higher-than-expected. He cautioned that "further surprises could be in store," but *does not expect increases of this size to be common.*
- In response to the question of whether the Fed might hike by 100 bps at a future meeting, Powell indicated it depends on the data, but did not specifically rule it out.
- On orchestrating a soft-landing, Powell indicated it would be challenging due to the war in Ukraine and supply chain problems, *both beyond the Fed's control*. He volunteered that the Fed was not trying to induce a recession.

Fed officials boosted their year-end forecast for PCE inflation from +4.3% at the March meeting to +5.2%, with a record 16 members perceiving upside risk in their forecasts.

After factoring in today's retail sales number, the Atlanta's Fed's *GDPNow model* is showing 0.0% growth for the second quarter. It's still early, but in the event that Q2 GDP is negative, it would represent two consecutive quarters of contraction. Granted, inventories and net exports are weighing heavily on the negative side, but it's hard to ignore the classic recession sign.

On orchestrating a soft-landing, Powell indicated it would be challenging due to the war in Ukraine and supply chain problems, both beyond the Fed's control.

The Fed is walking a tight line. Inflation is job one, but recession looms. Fed policy acts with a significant lag. As a result, overtightening is commonplace. *It's never clear you've pushed too hard until it breaks*. At some point, the chatter will shift to timing of the first cut, but that discussion is many months away.

The markets clearly liked what Powell had to say this afternoon, although after carefully listening to his entire press conference, the positive reaction must have been more about what he didn't say.

Market Indications as of 2:47 P.M. Central Time

DOW	Up 349 to 30,714 (HIGH: 36,800)
NASDAQ	Up 296 to 11,124 (HIGH: 16,057)
S&P 500	Up 92 to 3,827 (HIGH: 4,797)
1-Yr T-bill	current yield 2.87%; opening yield 3.08%
2-Yr T-note	current yield 3.23%; opening yield 3.40%
3-Yr T-note	current yield 3.38%; opening yield 3.56%
5-Yr T-note	current yield 3.41%; opening yield 3.56%
10-Yr T-note	current yield 3.35%; opening yield 3.44%
30-Yr T-bond	current yield 3.38%; opening yield 3.40%