23 March 2023

Amid Banking Turmoil, US Fed raises interest rates by another 25 bps

Key Highlights:

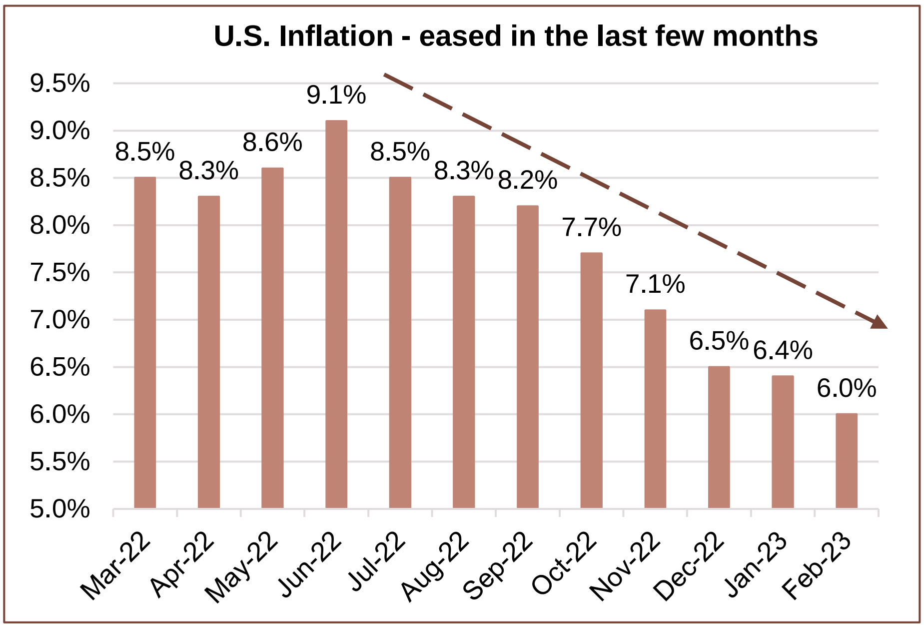
- The U.S. Federal Reserve (Fed) **raised its target interest rate by 25 bps to a range of 4.75%-5.00%**
- This 25 bps points hike has now taken the interest rates to a **15 year high i.e., since Sep 2007**
- That is just a half percentage point away from the Fed's estimated end point, or **terminal rate range of 5% to 5.25%.**
- In Feb 2023, **CPI inflation fell to 6.0%** as compared to 6.4% in Jan 2023.

Current Update:

- The Fed **pressed ahead with a quarter-point rise** after announcing one 50 bps hike and four-straight rate hike of 75 bps in 2022 as part of its aggressive battle to bring down the rising inflation that is plaguing the U.S. economy.
- The U.S. policy makers voted unanimously to lift their key rate to a **target range of 4.75% to 5.00%, its highest level since Sep 2007**.
- The Dot Plot Projections sees rates peaking at 5.1% in 2023 and coming down to 4.3% in 2024**.**
- **The Fed said that the US Banking System was "sound & resilient"** but there was uncertainty on the extent to which the fallout from the failure of two lenders would hit the economy**.**
- Members of the policy-setting committee removed the soft-repeated warning that **"ongoing increases"** would be necessary to curb inflation
- The committee in its statement said **"some additional policy firming may be appropriate"** to bring down the inflation to the banks 2% targe rate.

U.S. Inflation peeking:

- **Last year, inflation remained high,** soaring to record-breaking levels in June, **hitting a high of 9.1%.**
- Now, U.S. inflation data has shown a significant decrease over past few months. **In Feb 2023, CPI inflation fell to 6.0% over the year.**
- While **the pace of inflation is slowing, prices are still rising across the board**, particularly for groceries and housing.



Source: Trading Economics

Impact on U.S. Markets:

- U.S. markets fell following the press conference, indicating the investors expect a more dovish Fed going forward, **the S&P 500 dropped 1.65% to close at 3,937, while the Nasdaq Composite declined 1.6% to finish at 11,670 on March 22, 2023.**
- Worries persist that the Fed's aggressive battle against inflation could tip the economy into recession, and recent turmoil in the banking sector, sparked by failures of SVB Financial Group and Signature Bank, have increased those fears.

Fed Rate Hikes 2022-2023: Taming Inflation

FOMC Meeting Date	Rate Change (bps)	Interest Rate
22-Mar-23	+25	4.75% to 5.00%
01-Feb-23	+25	4.50% to 4.75%
14-Dec-22	+50	4.25% to 4.50%
02-Nov-22	+75	3.75% to 4.00%
21-Sep-22	+75	3.00% to 3.25%
27-Jul-22	+75	2.25% to 2.50%
16-Jun-22	+75	1.50% to 1.75%
05-May-22	+50	0.75% to 1.00%
17-Mar-22	+25	0.25% to 0.50%

Source: US Federal Reserve website

To Conclude:

The U.S. Fed policy rates may remain at the higher levels for longer till core inflation comes down towards 2%. While **Indian market expects the RBI to increase its policy repo rate by 25 bps in the upcoming monetary policy scheduled in April 2023 before taking a pause.** In India, the rising U.S. interest rates present challenges for the RBI Governor. When the Fed raises its policy rates, the difference between the interest rates of India and the U.S. narrows. This makes India less attractive for the currency carry trade. Further, a weakening rupee will put pressure on inflation via higher cost of imported goods and services.

We believe **Global equity markets, including the Indian markets will stay volatile for the time being, till the rate hike cycle continues globally amid Ukraine & Russia conflict, and its effect on global inflation**. The yield curve which measures the difference between long-term and short-term Treasury yields, shows **U.S. treasury yield curve inverts to depths not seen since 1980's**. Also, with further rate hike are on the cards for most of major developed economies across the world fear of **"stagflation"** are at their highest since the onset of the Great Recession in 2008.

Investment Approach:

Investors should not try to time the market and **investors should follow the desired asset allocation** to avoid unfavourable portfolio outcomes in case of any volatility that flows in the Indian markets due to tapering.

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