15 December, 2022

U.S. Fed hikes rates by 50 bps - signals more hikes to come next year

Key Highlights:

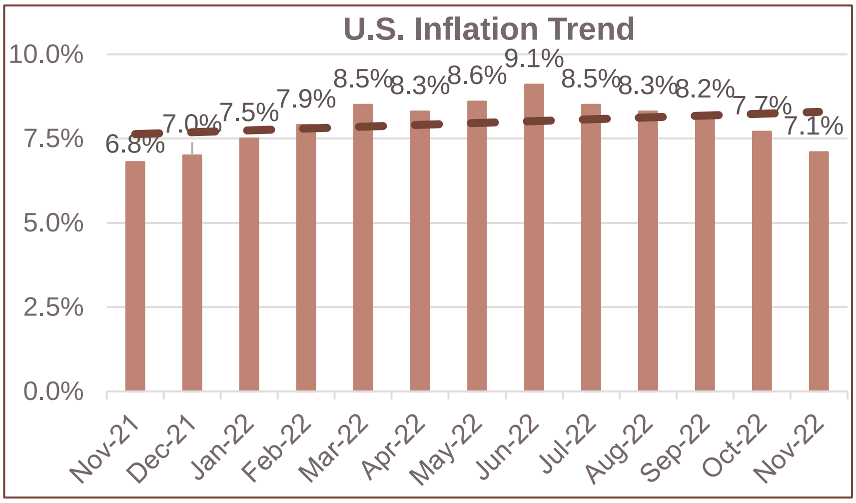
- The U.S. Federal Reserve **raised its target interest rate by 50 bps to a range of 4.25%-4.50%**
- This **50 bps points hike** has now taken the interest rates to a **15 year high i.e. since 2007**
- The **Fed projects raising rates as high as 5.1%** before ending inflation battle
- The U.S. **CPI inflation stood at 7.1% in November,** as against 7.7% in October

Current Update:

- The U.S. Federal Reserve (Fed) delivered a **slower pace of rate hike of 50 bps** after announcing 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 4.25% to 4.50%, its highest level since 2007**.
- "The inflation data received so far in October and November show a welcome reduction in the pace of price increases, but **it will take substantially more evidence to give confidence inflation is on a sustained downward path**". Powell said.
- Powell also added that **inflation battle not won, more rate hikes coming**.
- The **"ultimate level"** of the Federal Reserve's benchmark policy rate is estimated to be **as high as 5.1% in 2023** before ending the inflation battle.
- Policymakers expect their **interest-rate hikes to push the unemployment rate, now at 3.7%, to 4.6% in the final quarter of 2023,** and stay there through 2024. Three months ago, the jobless rate was seen rising to 4.4%.

U.S. Inflation peeking:

- U.S. inflation data has shown a moderate decrease in November compared to October 2022 on Y-o-Y basis. In November 2022, CPI inflation rose to 7.1% over the year.
- U.S. Consumer Price Index peaked at 9.1% Y-o-Y in June but it failed to come down as quickly in recent months as Fed officials had hoped.



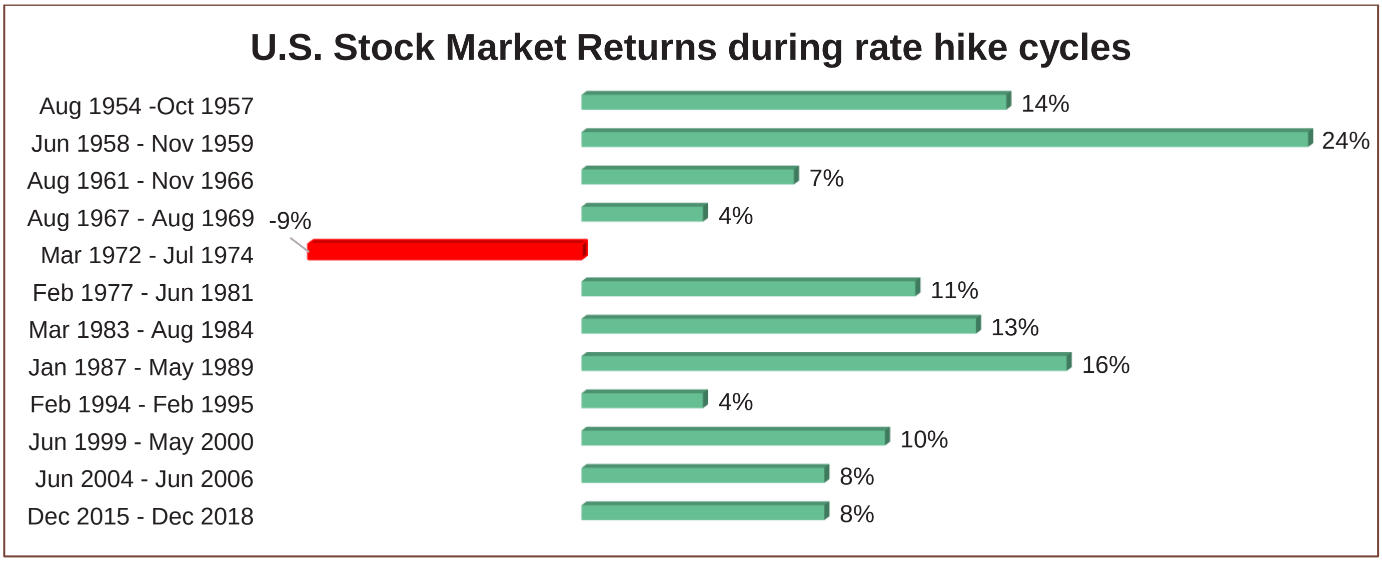
Source: Trading Economics

Impact on Markets:

- In reaction to the hawkish stance of the Fed, the U.S. equities, **the S&P 500 dropped 0.6% to close at 3,995, while the Nasdaq Composite slipped 0.8% to finish at 11,171 on December 14, 2022.**

- On December 15, 2022, **Indian stock markets fell**, tracking a slide in Asian peers, while the **rupee depreciated** 26 paise to 82.77 against the U.S. dollar.
- The benchmark **Indian 10-year government bond yield clsed flat at 7.24%** on December 15, 2022. On the previous day, it had ended at 7.22% levels.

History of 12 U.S. rate hike cycles have proven that the S&P 500 has risen by an average annualised rate of 9.4%



Source: Moneycontrol; Returns less than one year are absolute and greater than one year are CAGR

To Conclude:

The U.S. Fed policy rates may remain at the higher levels for longer till core inflations comes down towards 2%. While, in Indian **market expects the RBI to increase its policy repo rate by 25 bps in the upcoming monetary policy scheduled in February 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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