17 March 2022

Fed raises interest rates for the first time since 2018

Key Highlights

- Fed **raised interest rates by 25 bps** and **signaled hikes at all six remaining meetings this year**
- "**The American economy is very strong and well positioned to handle tighter monetary policy**," the Fed chair Jerome Powell told a press conference.
- **In a new economic projection** – Inflation significantly higher, growth target was lowered, and unemployment remained unchanged.

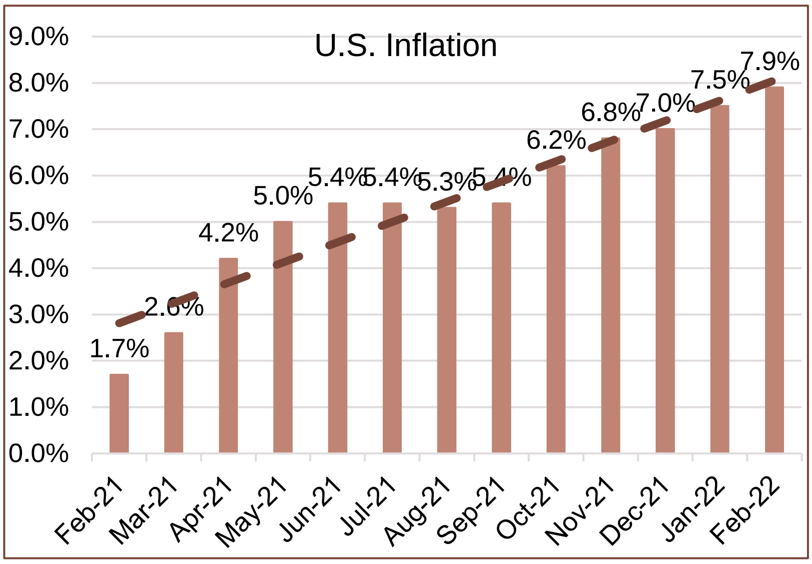
Key Highlights

- In line with expectation the Federal Reserve (Fed) on Wednesday **raised interest rates by 25 bps** and **signaled hikes at all six remaining meetings this year**, launching a campaign to tackle the fastest inflation in four decades even as risks to economic growth mount.
- The U.S. policy makers voted 8-1 to lift their key rate to a **target range of 0.25% to 0.5%**, the first increase since 2018, after two years of holding borrowing costs near zero to insulate the economy from the pandemic.
- "**The American economy is very strong and well positioned to handle tighter monetary policy**," the Fed chair Jerome Powell told a press conference; adding that "I saw a committee that is acutely aware of the need to return the economy to price stability."
- The Fed said it would **begin allowing its $8.9 trillion balance sheet to shrink at a "coming meeting"** without elaborating.
- In the Fed's so-called dot plot, officials' median projection was for the **benchmark rate to end 2022 at about 1.9%** -- in line with traders' bets but higher than previously anticipated -- and then rise to about **2.8% in 2023** which was earlier estimated at 2.8% in 2024.
- In a new economic projection, Fed officials said they see **inflation significantly higher** than previously anticipated, at **4.3% this year**, but still coming down to 2.3% in 2024. The forecast for **economic growth in 2022 was lowered to 2.8% from 4%**, while unemployment projections were little changed.

To Summarize

Fed is moving much quicker than it once expected to, mainly prompted by the failure to curb inflation as anticipated amid robust demand, supply chains imbalances and tightening labor markets. Investors pushed their expectations for rate increases following the meeting and now **project the Fed's policy rate to end the year to be at 1.9%.** Fed is also outlining principle to shrink its balance sheet as it stands at nearly $8.9 trillion, more than double its size before it began pumping money into the system in an effort to avert an economic meltdown in the wake of the COVID-19 pandemic. The war has sent the cost

Inflation zoomed near 4 decades high in February 2022 to 7.9%



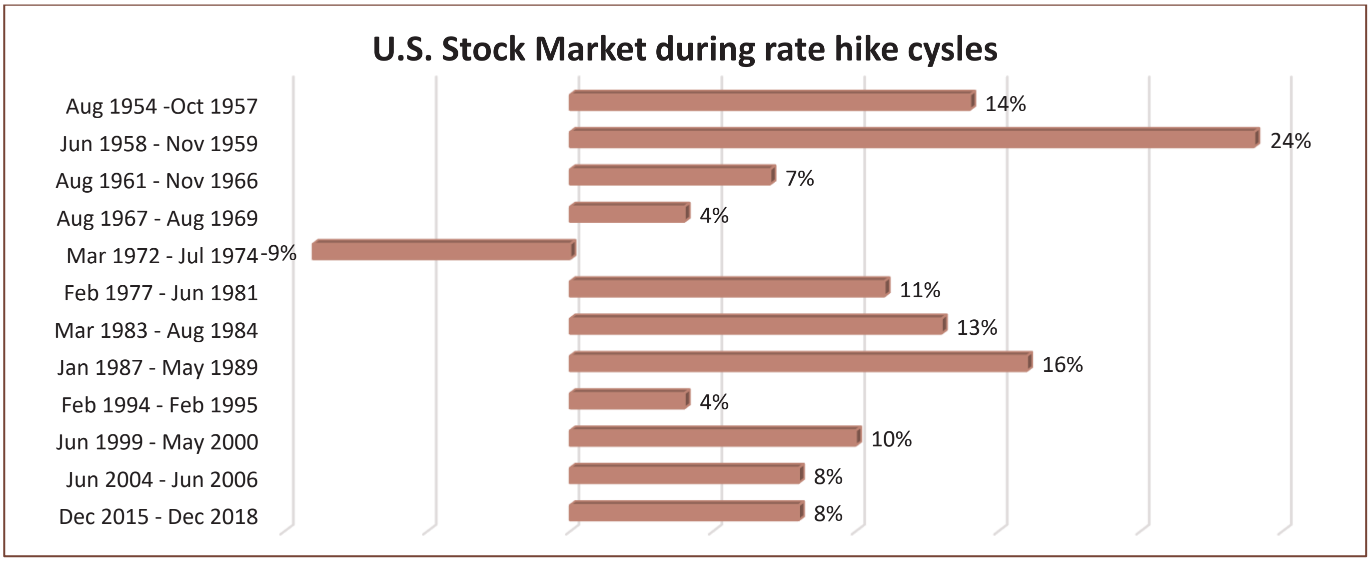
Source: tradingeconomics.com

of fuel, food and metals racing even higher, raising fears of 1970s-style stagflation by posing threats to prices, growth, and financial-market stability.

To Conclude

Hawkish commentary from the US central bank spooked the market briefly. The S&P 500 index briefly erased its gains on the decision before rebounding after Powell played down the risk of a recession and declared the economy strong enough to withstand tighter policy. The Index closed over 2% higher. While, in India the Equity Markets too ended the day higher and the India 10 Year GSec prices rose marginally.

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

We believe **market may remain volatile on back of interest rate hike by Fed, the Ukraine & Russia conflict, and its effect on global inflation**. Further investors will take clue borrowing calendar announced by the RBI at the end of this fiscal. The 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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17 March 2022

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