05 May 2022

Fed raises interest rates by 50 bps; largest increase since 2000

Key Highlights

- Fed **raised interest rates by 50 bps** and **signaled it would keep hiking at that pace over the next couple of meetings.**
- The Fed Chair - Jerome Powell, stated that it will begin **reducing its balance sheet size** by allowing its holdings of Treasuries and mortgage-backed securities to decline in June.
- **"Inflation is much too high and we understand the hardship it is causing and we are moving expeditiously to bring it back down,"** Chair Jerome Powell said.

Key Highlights

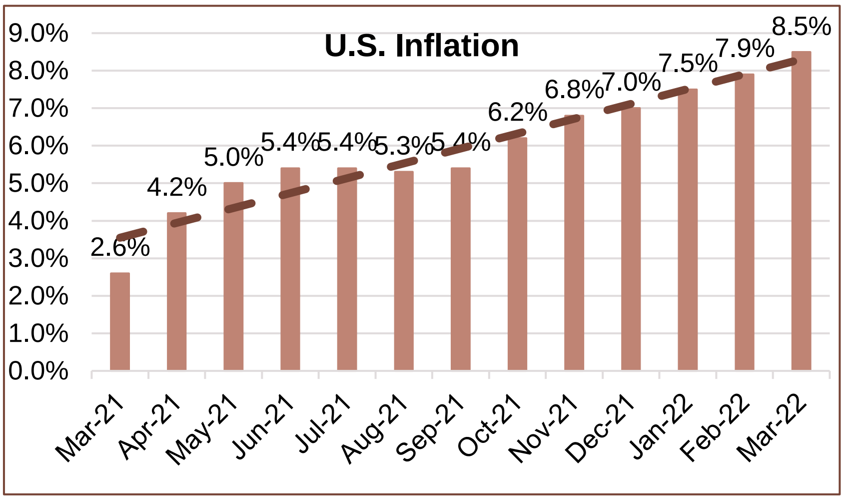
- In line with expectation the Federal Reserve (Fed) on Wednesday **raised interest rates by 50 bps - the biggest interest-rate increase since 2000** and **signaled it would keep hiking at that pace over the next couple of meetings,** unleashing the most aggressive policy action in decades to combat soaring inflation.
- The U.S. policy makers voted unanimously to lift their key rate to a **target range of 0.75% to 1.00%**, the second increase since 2018, after two years of holding borrowing costs near zero to insulate the economy from the pandemic.
- In a separate statement, it stated that it will begin **reducing its balance sheet size** by allowing its holdings of Treasuries and mortgage-backed securities to decline in June at an initial combined monthly pace of $47.5 billion, stepping up over three months to $95 billion.
- **"Inflation is much too high and we understand the hardship it is causing and we are moving expeditiously to bring it back down,"** Chair Jerome Powell said after the decision in his first in-person press conference since the pandemic began.
- FOMC said, "Although overall **economic activity edged down in the first quarter**, household spending and business fixed investment remained strong. Job gains have been robust in recent months, and the unemployment rate has declined substantially."

To Summarize

As **Fed softens hawkish stance**, as the **Fed Chair ruled out large, aggressive interest rate hikes** for the year as the central bank seeks to **contain inflation without triggering an economic recession**.

The substantial half-point hike in its benchmark short-term rate that the Federal Reserve announced Wednesday won't, by itself, have much immediate effect on most Americans' finances. **But additional large hikes are expected to**

U.S. Inflation touched a 4 decade high of 8.5% in March 2022



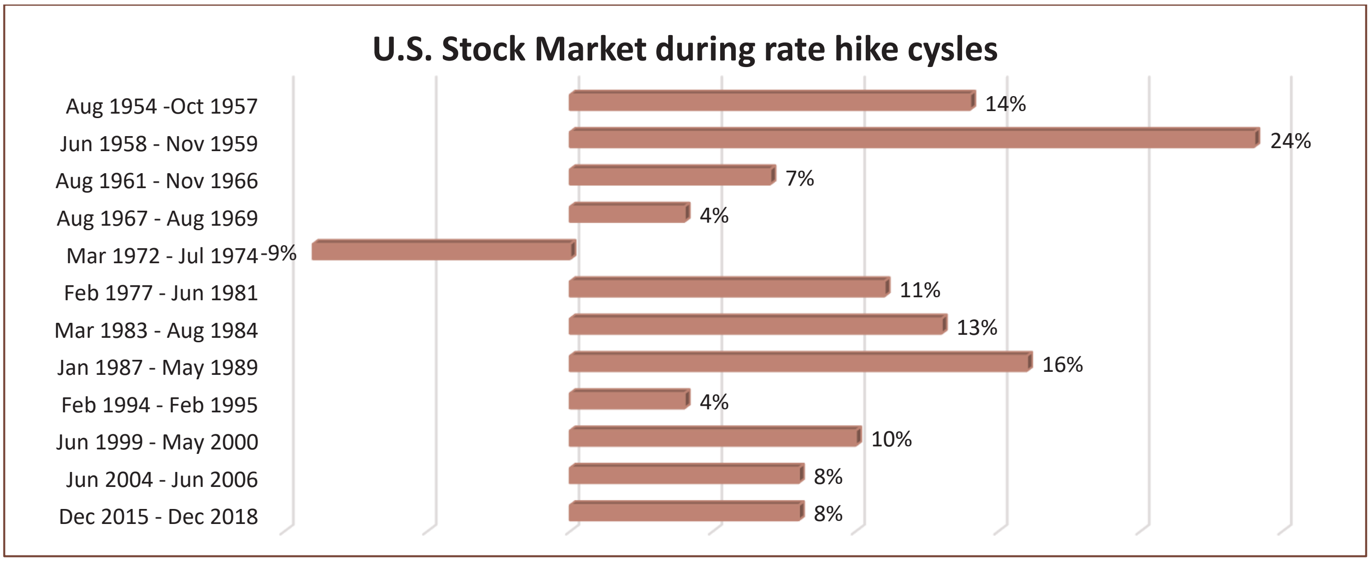
Source: tradingeconomics.com

be announced at the Fed's next two meetings, in June and July, and economists and investors foresee the fastest pace of rate increases since 1989.

To Conclude

In reaction to the softened hawkish stance of the Fed the U.S. equities – denoted by the **S&P 500 rallied ~3.00%,** while the **10-year U.S. Treasury yield hit 3% on Monday**, for the first time since late 2018 and it remained rather flat on the day of the hike. Back in **India the equity and debt markets** were already spooked by the rate hike announced in the unscheduled policy meet of the RBI, **continued to react negatively to the news**.

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 from the statement by **RBI** that it wishes to **withdraw ultra-accommodation** which it had implemented when the pandemic struck and cut the repo rate by 115 bps from 5.15% to 4.00%. The MPC in an off-cycle policy announcement yesterday already increased the key interest rates by 40 bps to 4.40%; it is believed that the remaining 75 bps hike may come in a couple of next policy meetings. 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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