16 June 2022

Fed raises interest rates by 75 bps; largest increase since 1994

Key Highlights

- Fed **raised interest rates by 75 bps** - to lift their key rate to a **target range of 1.50% to 1.75%.**
- New **dot-plot projections** showed sharp increase from March projections – **3.4% in 2022, 3.8% in 2023 & 3.4% in 2024.**
- FOMC said it **"strongly committed to returning inflation to its 2% objective".**
- **Growth forecast cut to 1.7% for 2022 & 2023,** from 2.8% and 2.2% projected in March.
- It will begin **reducing its balance sheet size** at an initial monthly pace of $47.5 billion a month.

Key Highlights

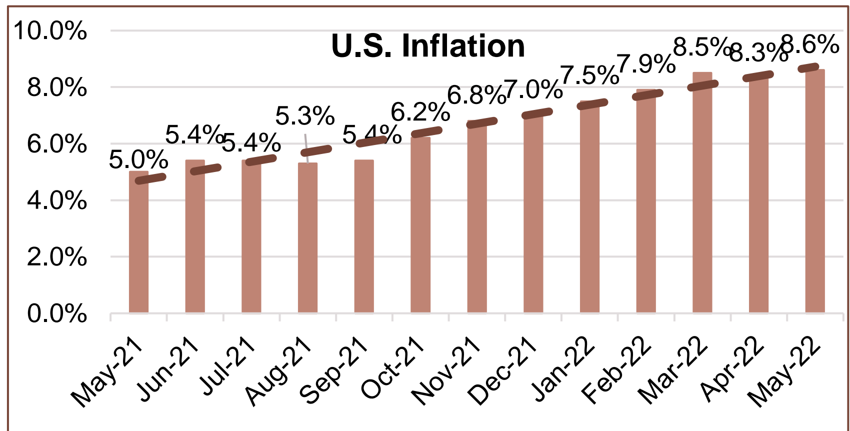
- In line with expectation the Federal Reserve (Fed) on Wednesday **raised interest rates by 75 bps - the biggest interest-rate increase since 1994** and **signalled equally-large hikes later this year,** unleashing the most aggressive policy action in decades to combat soaring inflation.
- The U.S. policy makers voted unanimously to lift their key rate to a **target range of 1.50% to 1.75%**, the third increase since 2018, after two years of holding borrowing costs near zero to insulate the economy from the pandemic.
- New **dot-plot projections** showed sharp increase from March projections, with federal funds target rising to **3.4% by year-end** -- implying another 175 bps of tightening this year -- and **3.8% in 2023**, before falling to **3.4% in 2024**; prior forecasts in March were for a 1.9% rate this year and 2.8% in 2023 and 2024.
- FOMC added a line saying it's **"strongly committed to returning inflation to its 2% objective"** and removes prior language that said the FOMC "expects inflation to return to its 2% objective and the labor market to remain strong".
- Economic projections showed the unemployment rate rising from 3.7% at end-2022 to 4.1% in 2024; **growth forecasts were cut to 1.7% in 2022 and 2023, from 2.8% and 2.2% projected in March**.
- It also 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 by September to $95 billion.

To Summarize

Even though in the **last meeting** the Fed chair **ruled out large, aggressive interest rate hikes** as the central bank seeks to contain inflation without triggering an economic recession; however it did announce the **largest hike in 28 years** and signaled more large rate increases to come that would **raise the risk of another recession.**

The substantial three quarters of a percentage point hike in its benchmark

U.S. Inflation touched a 4 decade high of 8.6% in May 2022



Source: tradingeconomics.com

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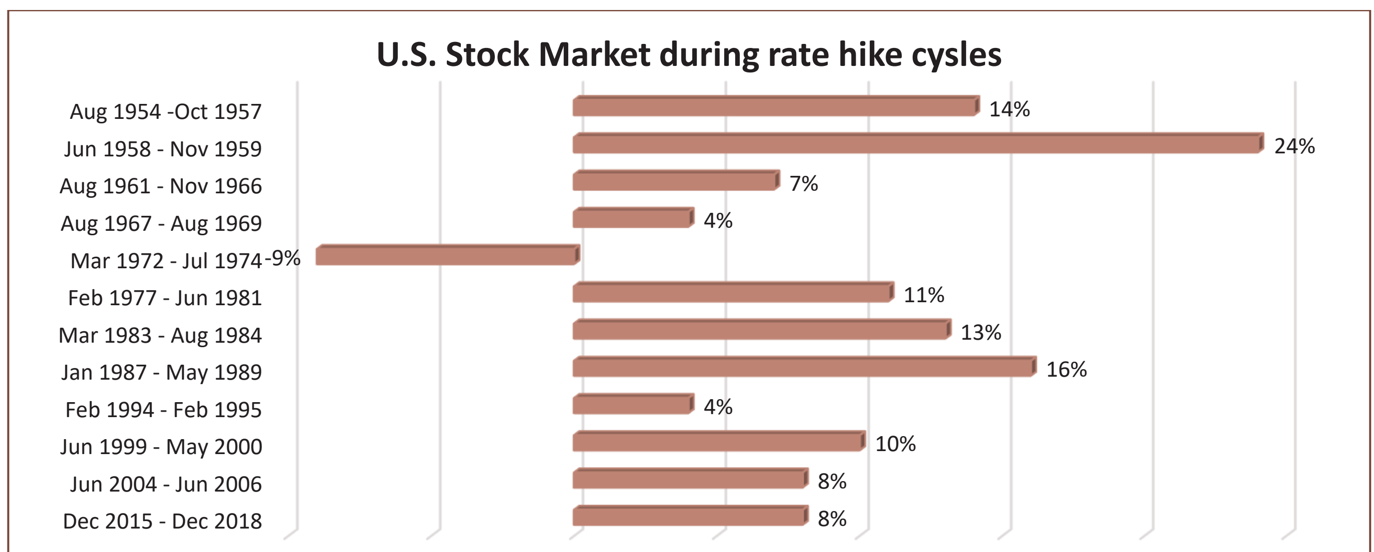
short-term rate that the Federal Reserve announced Wednesday may not, by itself, have much immediate effect on most Americans' finances. **But for the additional large hikes are expected to be announced at the Fed's next couple of meetings,** economists and investors foresee the fastest pace of rate increases since 1989.

To Conclude

In reaction to the hawkish stance of the Fed the U.S. equities – denoted by the **S&P 500 rallied ~1.46%,** while the **10-year U.S. Treasury yield softened to close at 3.29% on Wednesday after touching a fresh 11 year high of 3.46% earlier during the day**. Back in **India the equity and debt markets** were already in the red on the back of aggressive rate hikes and global inflation fears continued to remain so on Thursday too.

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.** With further rate hike are on the cards for most of major economies across the world (Bank of England set for fifth straight rate hike today) **fear of "stagflation" are at their highest** since the onset of the Great Recession in 2008. 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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