4 May 2023

U.S. Fed hikes interest rate by 25 bps – data dependent approach for future rate hikes

Key Highlights:

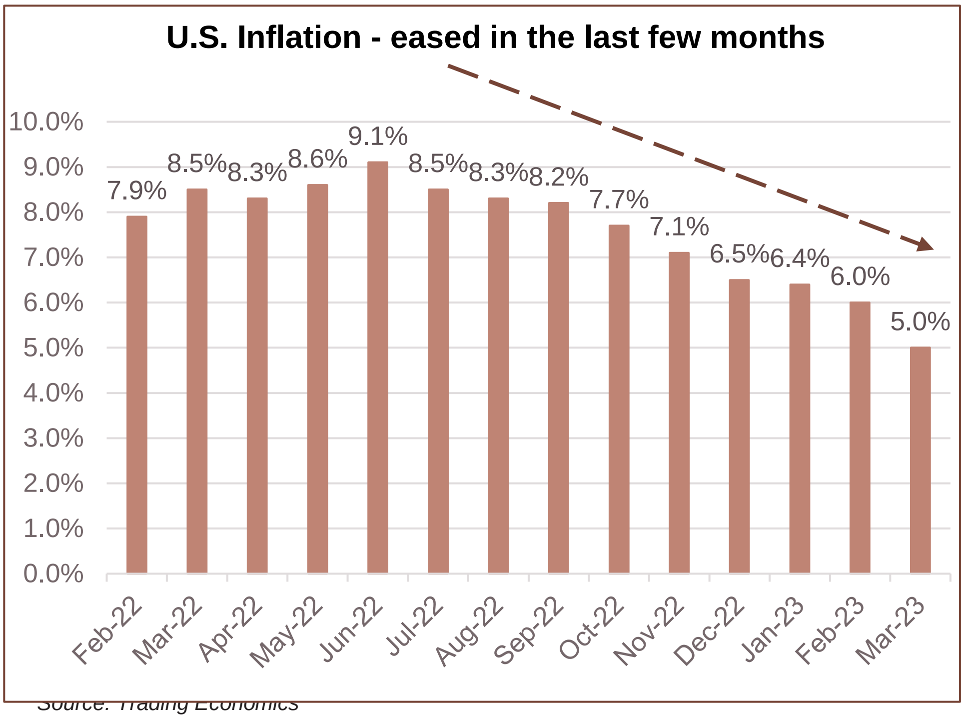
- The U.S. Federal Reserve **raised its target interest rate by 25 bps to fight inflation despite banking crisis and recession fears.**
- **FOMC took interest rates to a range of 5% to 5.25% —** the highest since August 2007.
- This was the **tenth-straight interest rate hike since March 2022.**
- Fed indicated it will take **data dependent approach** to determine extent of further change in interest rates.
- **The US CPI inflation stood at 5.0% in March,** nearly three times the Fed's target level of 2.0%

Current Update:

- The Fed **pressed ahead with a second 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 5.00% to 5.25%, its highest level since August 2007**.
- **The Fed said that the US Banking System was "sound & resilient".** Tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation.
- The committee in its statement said that it seeks to achieve maximum employment and inflation at the rate of 2% over the longer run.

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 Mar 2023, CPI inflation fell to 5.0% over the year.**
- **While the pace of inflation is slowing**, it is still above the target rate of 2%.



Source: Trading Economics

Impact on U.S. Markets:

- U.S. markets rose following the press conference, indicating the investors expect a more dovish Fed going forward, **the S&P 500 was up 0.3% to close at 4,090, while the Nasdaq Composite rose 0.6% to finish at 12,025 on May 3, 2023.**
- Investor sentiments were dented as Fed ruled out cutting interest rates anytime soon given higher than expected inflation. Failure of three major banks within two months and adverse impact on economic activity due to tighter credit conditions for household and businesses raises concerns recession in U.S.

Fed Rate Hikes 2022-2023: Taming Inflation

FOMC Meeting Date	Rate Change (bps)	Interest Rate
03-May-23	+25	5.00% to 5.25%
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. key policy rates may remain at the higher levels for longer till core inflation comes down towards 2%. Recent production cuts by OPEC and tight US labor market may put upward pressure on inflation and may keep the Fed from rate cuts.** While RBI kept repo rate unchanged against the wide expectations of rate hike citing growth concerns in the last policy meet in April 2023.

With turmoil in banking sector, fear of recession and continued conflict between Ukraine and Russia and its impact on global economy, we believe **global equity markets, including the Indian markets will stay volatile in near term.** Impact of aggressive rate hikes by many of the global economies can be seen on the economic activity and growth. 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**.

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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