FED WATCH: END OF THE LINE?

Kevin Flanagan — Head of Fixed Income Strategy
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For the first time since the Federal Reserve began raising rates in March of last year, the FOMC voting members did not implement any increase at the June FOMC meeting. As a result, the Fed Funds trading range remains at 5%–5.25%, still the highest level since 2007. With Powell & Co. taking a pause from rate action, the more important question going forward is, now what?

Over the last month or so, the money and bond markets couldn't figure out what the next steps for the policy makers would be. Immediately following the May FOMC meeting, expectations were for the Fed to possibly cut rates in June, and if not then, most assuredly at the July gathering. A funny thing happened afterward, as the narrative shifted to the 'skip & hike' school of thought—taking a pause in June and a better-than-50% probability of an increase at next month's Fed meeting.

Interestingly, Chairman Powell may not necessarily share this outlook. If there has been any constant throughout this latest rate hike cycle, it has been how the Fed and the bond market just haven't been on the same page. It all started with the 'inflation is transitory' stance from the policy makers before rate increases began and then shifted more recently to the notion the Fed would be cutting rates sooner and by a larger magnitude than Powell was envisioning. Now, it's like we've come full circle. The implied probability for Fed Funds Futures is no longer for multiple rate cuts this year, but for just one, as of this writing.

That brings us back to the question of what investors should be expecting in terms of U.S. monetary policy for the remainder of this year. From the Chairman's perspective, the Fed seems to be weighing the full impact of the 500 basis p oints (bps) in rate hikes that have already occurred in conjunction with the expected further tightening in credit conditions from the regional banking fallout. This puts the policy makers in full 'data dependent' mode and has recently given rise to the notion that decisions will be made on a meeting-by-meeting basis.

However, in my opinion, the bar has definitely been raised for another rate hike. It would not only take a stalling out in progress on the inflation front, but also—and this is arguably even more important—signs of continued firmness in the labor market. In addition, based on various reports, it appears Powell is not a fan of the 'stop-and-go' approach to policy decisions.

The Bottom Line

While another rate hike cannot be completely ruled out in the current data dependent stance, it does seem as if the Fed is now either at, or close to, the end of this rate hike cycle. The aforementioned skip & hike debate will more than likely be in the headlines, but I think the more important thing to focus on in portfolio decision-making is that rates are looking like they will be 'higher for longer.'

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Fed funds target range : the interest rate band the Federal Open Market Committee decides to implement for the federal funds rate.

Bond market : The bond market—often called the debt market, fixed-income market, or credit market—is the collective name given to all trades and issues of debt securities. Governments typically issue bonds in order to raise capital to pay down debts or fund infrastructural improvements.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Inflation : Characterized by rising price levels.

Basis point : 1/100th of 1 percent.

Fed tightening : Refers to the Federal Reserve enacting monetary policies that have the overall impact of reducing the availability of credit, which is widely thought to have the potential to slow economic growth.