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Markets and Economy

After Fed's First Move, Next Rate Hikes May Come Faster than Expected

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"The FOMC has raised rates for the first time since 2018. The big question is how fast it will have to keep raising them, as the crisis in Ukraine injects yet more uncertainty into the prospects for the global economy."

Boston - As was widely expected, the Federal Open Market Committee (FOMC) voted to increase the federal funds rate by 0.25%, to a target range between 0.25% and 0.50%. In what was certainly a bit of a hawkish surprise from the Fed's policy-setting committee, its "dot plot" of rate forecasts showed seven hikes this year, up from three projected at its December meeting.

The seven-hike pace implies a fed funds rate of 1.875% by the end of 2022 — a full percentage point higher than the FOMC's previous projection. The dot plot also projects the fed funds rate hitting about 2.8% in 2023 and 2024, before settling back to a "long-term" rate of 2.4%. The projections for 2023 are also more than a point higher than predicted by the FOMC in December.

As for inflation, the FOMC substantially hiked its 2022 forecast based on personal consumption expenditures (PCE) to 4.3% from 2.6%, and bumped the 2023 projection to 2.7% from 2.3%. The change in real U.S. GDP growth was revised downward to 2.8% from the 4.0% predicted in December.

Markets react quickly to Fed and Ukraine news

The FOMC statement, when released at 2:00 p.m. on March 16, initially prompted a big sell-off in the bond market. This was particularly apparent at the front end of the yield curve, which immediately tacked on 13 basis points (bps).

But the other major crosscurrent in the market — the Russia/Ukraine conflict — appeared to be buoyed by a "cease-fire trade," and the risk-on sentiment resumed.

Bond yields settled back, oil and non-dollar currencies gained and the S&P 500 Index added 2.24% for the session. Comments from Fed Chair Jerome Powell seemed more muted than the FOMC statement, which also helped to bring rates down as the afternoon progressed.

Monetary tightening process begins

However, it is very clear that we are at the beginning of the rate hiking process. I believe that 25 bps is now the "preset," with the potential for a 50 bps hike depending on the path of inflation, growth and financial markets. It is noteworthy that seven of the 12 FOMC members indicated that they expect more than seven hikes in 2022, which implies at least one 50 bps hike at one of the six remaining meetings this year.

The FOMC also indicated that it would start shrinking the Fed's balance sheet in a few months, reducing its holdings of Treasury securities, agency debt and agency mortgage-backed securities.

Bottom line: The FOMC has raised rates for the first time since 2018. The big question is how fast it will have to keep raising them, as the crisis in Ukraine injects yet more uncertainty into the prospects for the global economy.

S&P 500 Index is an unmanaged index of large-cap stocks commonly used as a measure of U.S. stock market performance.