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The US Federal Reserve has increased the Fed Funds rate

Synopsis: The US Federal Reserve increased the Fed Funds rate by 0.25% to 5.00%-5.25%.

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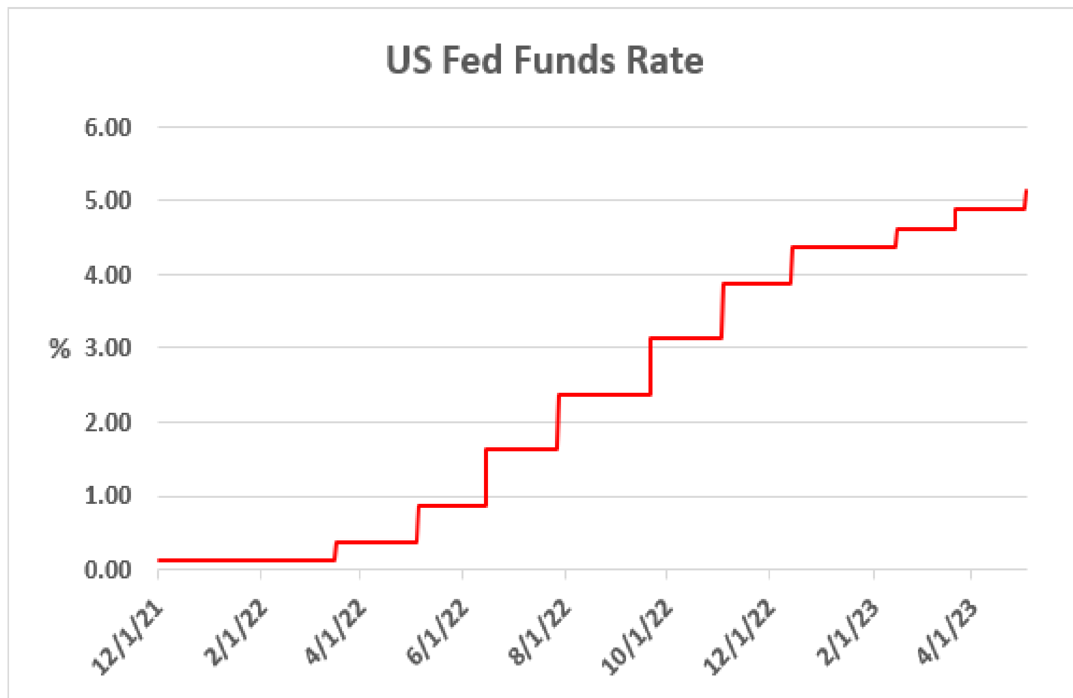

Last night the US Federal Reserve added another 0.25% to its Fed Funds Rate, taking it up to 5.00%-5.25%. It was the tenth consecutive increase and the third of 25 bps. The rate is now back at the level last seen in 2007, ominously its peak before the Global Financial Crisis hit. Nearly all yesterday's bets had been on a quarter point rise and the market's main focus was thus – as usual – on what indications the Fed gave of its next moves.

Here there was a notable change in the Fed's accompanying press release from its stance at the start of March, which arguably boiled down to one word. In March, the minutes said...

'The Committee anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.'

In May, anticipation gave way to determination...

'In *determining* the extent to which additional policy firming may be appropriate to return inflation to 2 percent over time the Committee will take into account the

cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments.'

The new wording was immediately interpreted as pointing to a pause in rates after the consecutive pattern of increases over 14 months that had added a cumulative 5%. With that information, the markets then turned to the next 'what next' – when will rates fall?

At Powell's press conference, the Fed Chairman dealt with this question firstly by saying that the Fed did not envisage that conditions/data would favour any move down in 2023. However, he conceded that if the Fed's expectations were wrong, then earlier cuts were possible.

The net result was that markets, which foresee a recession forcing the Fed's hand, ended the day signalling that the Fed rate would be around 4% by January 2024. Two-year Treasury bond yields fell 0.13% on the day to 3.80%. A little under two months ago, they were nudging 5%.

Comment

The Fed's tilt towards what some have described as a 'hawkish pause' could mark the top of the current interest rate cycle. There will still be more rises elsewhere this month, with the European Central Bank due to announce today (Thursday) and the Bank of England in a week's time. Neither the ECB nor the Bank have tightened as sharply as the Fed and both face higher rates of inflation, so they may add one more increase after May's before arriving at their pause.

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