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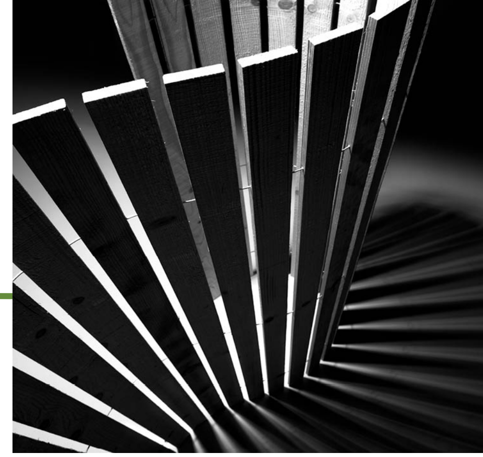
# MARKET SIGHT*LINES*



## The Federal Reserve Hikes 0.75% Again: The Timing of a Policy Shift Remains Elusive

By Michael O'Keeffe, *Chief Investment Officer*

Last week, we wrote about finding balance in several areas. But this week's Federal Reserve (Fed) policy decision and Chair Jerome Powell's press briefing make discerning the timing of a rate hike pause still elusive.

In this week's Sight|Lines, we share the results of the November Fed meeting, how the third quarter GDP report played a role, and what these mean for investors trying to find balance on the topics of inflation and recession.

### THE TAKEAWAY: THE FED SENDS MIXED SIGNALS BUT STAYS HAWKISH…FOR NOW

The Fed hiked rates another 0.75%, as expected, but sent some mixed signals while communicating its policy decision.

- Market participants were looking for a possible "hike, watch, and maybe pause" orientation from the Fed.
- So, investors welcomed a revised statement with new language explaining that the Fed will take "cumulative tightening" and "lags" into account to determine the pace of future increases.
- But Chair Powell signaled in his press conference that the Fed will continue its inflation fight, saying:
  - "The U.S. economy has slowed significantly from last year's rapid pace… (but) the labor market remains extremely tight, with the unemployment rate at a 50-year low… (and) price pressures remain evident across a broad range of goods and services."
  - "It is very premature to be thinking about pausing."
  - "…we still think there's a need for ongoing rate increases, and we have some ground left to cover here — and cover it, we will."
- We will learn more about the Fed's thinking when meeting minutes are released on November 23.

### IN-DEPTH: THE STATEMENT PROVIDES ROOM FOR A PAUSE, BUT POWELL SAYS NOT YET

The Fed sent mixed signals in the wake of its policy meeting this week, with the statement providing room for the central bank to monitor the lagged effect of its already tighter policy, but Fed Chair Jerome Powell said the Fed expects to continue rate hikes to combat inflation, perhaps to a level even higher than previously expected.

The Fed is known to be data dependent, watching the data and the effect of current policy on inflation, the economy, and, more specifically, jobs. And its latest statement included the following new language:

*In determining the pace 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.*

Investors interpreted this addition as a signal that the Fed is acknowledging that its rate hikes will still have a lagged effect on the economy, demand, and inflation so it will take this into account when setting future policy, giving rise to a strong potential of a rate hike slowdown.

In his press conference, Chair Powell explained the data shows an economic slowdown:

*The U.S. economy has slowed significantly from last year's rapid pace. Real GDP rose at a pace of 2.6% last quarter but is unchanged so far this year. Recent indicators point to modest growth of spending and production this quarter. Growth in consumer spending has slowed from last year's rapid pace, in part reflecting lower real disposable income and tighter financial conditions. Activity in the housing sector has weakened significantly, largely reflecting higher mortgage rates. Higher interest rates and slower output growth also appear to be weighing on business fixed investment.*

So, the Fed sees its policy as slowing the economy but also considers the job market very tight:

*Despite the slowdown in growth, the labor market remains extremely tight, with the unemployment rate at a 50-year low, job vacancies still very high, and wage growth elevated…the labor market continues to be out of balance, with demand substantially exceeding the supply of available workers. The labor-force participation rate is little changed since the beginning of the year.*

A strong job market is important for discerning future Fed policy in this environment for two reasons. First, a strong consumer means more demand, which puts upward pressure on inflation. And then second, high inflation with a strong job market means the Fed's dual mandate is out of balance, so the central bank has more room to tighten policy and soften the job market to cool inflation.

One final point to share. While his comments were more stream of consciousness, Chair Powell seemed to indicate that we should expect the December Summary of Economic Projections (SEP) to signal even higher fed funds rates than were published in the September SEP:

*…the level of rates that we estimated in September…the incoming data suggests…that's actually going to be higher…the ultimate level of interest rates will be higher than previously expected.*

So, the Fed can be data dependent in both directions to slow rate hikes or signal that it must go higher.

## CONCLUSION

We've been discussing finding balance in several areas, including Fed policy. But this week's Fed policy decision and Chair Jerome Powell's press briefing make discerning the timing of a rate hike pause still elusive. We do believe we will find balance on Fed policy by early 2023, but to quote Chair Powell, "We have a ways to go."

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