

# MILL CREEK

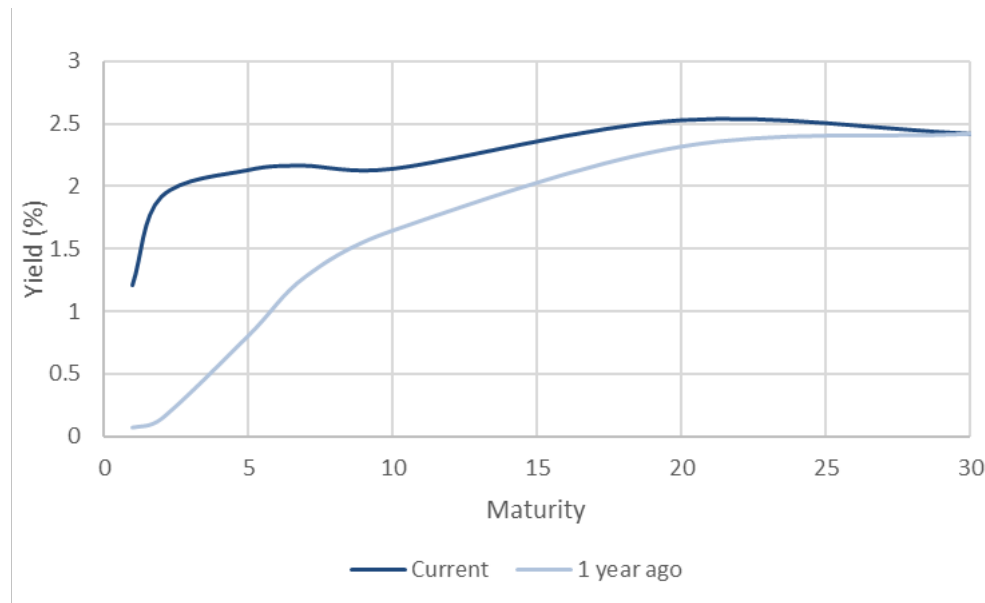
Our values appreciate yours

WEEKLY UPDATE

March 21, 2022

## MARKET COMMENTARY

Fig. 1: The Treasury yield curve flattened over the last twelve months



Source: Bloomberg, Mill Creek.

As widely expected, the Federal Reserve approved its first rate hike in over three years last week. This move starts what will likely be a tumultuous hiking cycle. Some key points from the Federal Open Market Committee (FOMC) meeting:

- All FOMC members voted for a rate hike, but James Bullard wanted to hike 0.5% instead of 0.25%.
- The Fed will focus on month-to-month inflation readings to guide policy.
- Balance sheet runoff will likely begin in May.
- FOMC members now expect inflation to average 4.1-4.7% this year (up from 2.2-3% in December) and the Fed Funds rate to finish the year between 1.6-2.4% (up from 0.6-0.9% in December).
- FOMC members believe 2.3-2.5% is a fair longer-run neutral Fed Funds rate.

Our perspective:

- These new FOMC estimates are more aligned with our expectations for Fed action this year. We continue to expect 7 rate hikes with some upside risk to that forecast. It is likely that the Fed will hike at 50bps at one of the next two meetings.
- The Fed risks inverting the yield curve (Fig. 1) by the end of 2022 or early 2023 if longer-term rates remain stable.
- This hiking cycle will be a tightrope. Demand growth remains excessive, so tightening is necessary, but the Fed must look through supply-driven inflation for as long as it takes.

- Aggregate income and labor market health will be a good indicator of appropriate policy. If unemployment ticks up or aggregate income growth falls below trend, the Fed will need to pause even if inflation remains above trend. Doing otherwise will risk a recession.

## QUICK LINKS

- [The Driving Forces of Inflation](#)
- [Normalization Ahead for Earnings](#)
- [March Market Update](#)
- ["If you hear missiles flying..."](#)

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