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March 27, 2023

MARKET COMMENTARY

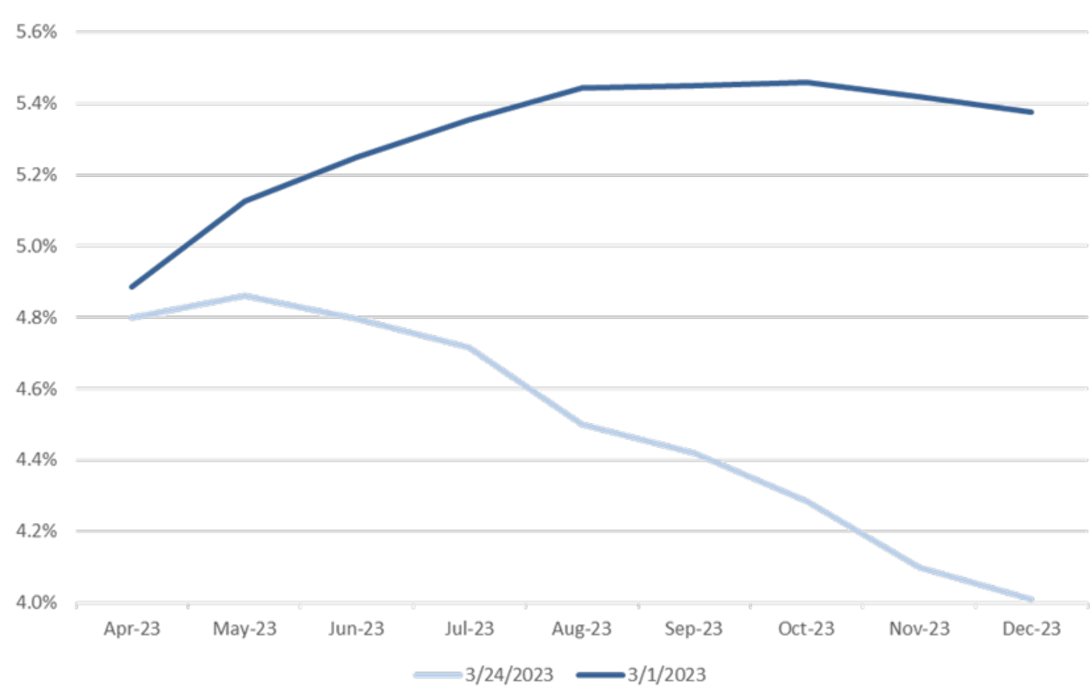
Stuck Between a Rock and a Hard Place

Leading up to last week's FOMC meeting, the banking industry's turmoil generated more press than usual. Inflation took a temporary back seat as concerns over financial stability led investors to abruptly revise downward their expectations for future rate hikes. Last week's +25 basis point increase (lifting the Fed Funds rate to 4.75%-5%) reflected a balancing act by the Fed to address several competing factors.

Going forward, does the high degree of uncertainty plaguing the banking sector mean the Fed's rate hiking cycle is over? The market seems to think so. Currently, Fed Funds futures pricing data shows no hikes in May or June, and a cut in each meeting from July through December. This stands in stark contrast to data gathered in early March which forecast a terminal rate of 5.5% and no cuts through 2023.

The question at hand is will a cutback in bank lending be enough to tame inflation without additional rate hikes? At the FOMC's press conference, Powell emphasized that tighter credit conditions act as a 'substitute' for rate hikes, and it will take time to assess how significantly the effects flow through to the economy. The situation remains fluid and we expect monetary policy will adjust accordingly, but with inflation still well above the 2% annual target, Powell's job just got much harder.

Fig. 1: Fed Funds Futures



Source: Bloomberg, Mill Creek

QUICK LINKS

- House View Summary
- The Increasing Likelihood of Unlikely Events
- Move Quickly and Break Things
- Private Remains Resilient Amid Tech Sector Downturn (White Paper)

This week's contributor: Nora Pickens, CAIA

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