TAKE FIVE with Bill Emmons

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## Fed Raises Rates and Anticipates Additional Increases. Markets Expect Many More to Come

## Transcript

**Bill Emmons:** Hi, I'm Bill Emmons, and I'd like to talk about the FOMC meeting that took place March 15 and 16. As you probably know, the Fed began its tightening cycle. At the same time, stagflation worries are growing. So I think the most important meeting takeaways include the fact that the Fed raised its interest rate targets by 25 basis points. St. Louis Fed President Jim Bullard dissented from this decision, arguing that the Fed should move by a full 50 basis points. The bond taper concluded—that is, the Fed is no longer purchasing assets on large scale, but there's no word yet on when quantitative tightening might begin.

The Fed's outlook for the economy reflected these rising stagflationary concerns. And what I mean by that is economic growth was revised down in the forecast from 4% to 2.8% for this year, and inflation was revised up in those projections from 2.6% to 4.3%. And slowing growth and above-target inflation are expected now to persist in '23 and '24.

So the near-term outlook for monetary policy: First of all, policy clearly has a long way to go. The FOMC signaled rate increases at every meeting this year. And the drawdown of the Fed's $9 trillion balance sheet may begin as soon as May.

So let's look at some of those projections from the quarterly summary of economic projections. For real GDP growth from the fourth quarter of 2021 to the fourth quarter of '22, the forecast was revised down. This is the median member's projection from 4% to 2.8%—pretty sizable decline. And in the '23–'24 period, slowing growth expected to continue. As for unemployment, it remained at 3.5%, the projection for the fourth quarter of 2022, and that is likely to continue in '23 and '24. As for inflation, a very large increase projected for this year. As recently as December, the projection was 2.6%. Now the median member of the FOMC is looking for 4.3% in the fourth quarter of this year. And the path for the fed funds rate has been moved up again to above the neutral level that the Fed believes exists.

So this picture shows you that going back just a year, in March of 2021—it's kind of hard to believe this, looking back—but the median member of the FOMC expected no rate increases at all through 2023 and sometime after that only beginning. But in each quarterly projection, the path of the funds rate has been bumped up and up, and the biggest move occurred at this meeting. So now the median member is looking for fed funds almost at 2% by the end of this year and then pushing up next year closer to 3%.

And the way that probably would map out—and now I'm switching to the financial market forecasts—this is suggesting that we'll see increases at every meeting, and the markets now are looking for at least one 50 basis point increase. At this point, it's penciled in for June, but this would bring the fed funds target range to 2 to 2.25% by the end of this year. As I said, the FOMC projects not quite as high at that point.

So I think the implications for banks include clearly the signal that the Fed has begun a tightening cycle. It's likely to lift short-term rates more rapidly—and possibly higher—than they went in 2015–18. And the terminal fed funds rate—that is, where this tightening process tops out—could approach 3% by late 2023. And this is according to both those FOMC projections and financial markets. Chairman Powell suggested in the press conference that quantitative tightening will begin soon and that that should add some contractionary force to the rate increases.

So at this point, the economy looks strong, but it's projected to slow significantly, and those inflation pressures are definitely out there. So I think what we should expect: Worsening measures of inflation or inflation expectations, if they occur, could trigger a more aggressive Fed and more volatile financial markets. Meanwhile, the flattening yield curve signals growing investor concerns about a sharper economic slowdown later this year or in 2023. And I think it pays to keep your eyes on President Bullard. President Bullard fears that the Fed is not moving fast enough to fight inflation. So I think you should look for him to dissent again at future meetings if the pace of tightening is not increased from current projections.

Thanks for listening, and we'll see you next time.

(END OF RECORDING)