

Federal Reserve minutes: Higher... but not too high!

The minutes to the Federal Reserve's July FOMC meeting point to ongoing rate hikes to ensure that inflation and inflation expectations don't become embedded. However, "many" participants fear they could end up going too far into restrictive territory, which suggests a clear chance the Fed ends up reversing course next year



Federal Reserve

Source: Shutterstock

Rates to rise further, but more slowly

The minutes to the July Federal Open Market Committee meeting suggest the Fed will remain on a tightening path, but there are signs some officials are getting a little nervous that they could end up going too hard and may need to reverse course eventually. "Ongoing increases in the target range for the federal funds rate would be appropriate" with policy needing to move to a "restrictive stance", but that "it likely would become appropriate at some point to slow the pace of policy rate increases".

That is as hawkish as it gets. No discussion it seems of a once mooted 100bp hike for July. Instead, there is an acknowledgement from "a number of participants" regarding signs that the economy

was reacting to policy actions “more rapidly than had historically been the case”. While recognising the need to prevent inflation from becoming entrenched, “many participants remarked... there was also a risk that the Committee could tighten the stance of policy by more than necessary to restore price stability”.

50bp and 75bp still in play for September, but growing chance of 2023 cuts

There is no real forward-looking guidance unlike the June minutes when the Fed suggested July was either going to be a 50bp or a 75bp hike. We have another jobs report and another CPI report plus the Fed’s Jackson Hole conference starting next week so there will be plenty of chance for the Fed to try to shape expectations. It is still all to play for with the market continuing to hedge its bets, pricing 63bp of hikes at the September FOMC meeting.

We are still saying 50bp September, 50bp November and 25bp December, but if we got another 350k jobs print for August and CPI failed to show any moderation from the 8.5% headline and 5.9% core then we would likely switch to a 75bp call for September. However, we do worry that the growth outlook will deteriorate markedly after what should be a decent 3Q GDP print. A China slowdown, European recession and a domestic US housing downturn look set to push the US closer to what might feel like a “real” recession with rate cuts looking a distinct possibility for mid-2023.

Three things stand out from a markets perspective

1. The Fed thinks that real rates are still too low, even as they deem the nominal fed funds rate as being now at a neutral level. Ammunition there for expectations for higher nominal market rates, even though the impact reaction has been to test lower for rates, and for the belly of the curve to richen.
2. The Fed seems to be all over the place when assessing where financial conditions are. They note they are much tighter now (which is true versus where they were at the end of 2021), but at the same time note a relative ease to get access to credit and decent demand for it (which is indicative of a loosening in conditions). Since the minutes, financial conditions have loosened further; not ideal for a Fed that wants to tighten.
3. The Fed seems happy with the functioning of the reverse repo window, at which there is a 2.3% rate on offer. They also note that the doubling in the balance sheet roll-off volumes in the months ahead should ease the usage on the facility. We are certainly beginning to see this, as the usage seems to have plateaued, albeit from staggeringly high levels.

Overall, the market has seen yields fall a tad on the back of the minutes, but not in a dramatic fashion. Looking through this and focusing more on the Fed need to in fact tighten conditions further, market rates should be forced higher despite the impact effect seen.

Authors

James Knightley

Chief International Economist, US

james.knightley@ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.