

Fed's Powell confirms March lift-off

Jerome Powell has signalled that the strong economy and elevated inflation makes it appropriate to hike rates in two weeks' time. However, Russia's invasion of Ukraine has created significant uncertainty, meaning there's no preset path for rate hikes



March hike on its way, but no preset path

The Federal Reserve has released Chair Jerome Powell's semi-annual testimony to the House Financial Services Committee and in it he confirms the Fed's desire to raise rates on 16 March. "With inflation well above 2% and a strong labour market, we expect it will be appropriate to raise the target range for the federal funds rate at our meeting later this month."

He reiterated that raising the Fed funds rate is the "primary" tool used to tighten monetary policy, but the Fed will also shrink its \$9tr balance sheet. This will "commence after the process of raising interest rates has begun, and will proceed in a predictable manner primarily through adjustments to reinvestments".

Of course, the uncertainty and the economic hit from sanctions following Russia's invasion of Ukraine was addressed, but there is only so much that the Fed can say and unsurprisingly he kept to stating that there will be no preset path to policy tightening and that the Fed will respond to the newsflow/data as it comes. "Making appropriate monetary policy in this environment requires a

recognition that the economy evolves in unexpected ways. We will need to be nimble in responding to incoming data and the evolving outlook."

Russia situation requires a 'nimble' Fed

After Powell's hawkish shift at the January Federal Open Market Committee (FOMC) meeting, markets went as far as to price a 90% chance of a 50bp Federal Reserve hike on 16 March and up to 160bp of interest rate hikes for the year. However, expectations have been scaled back sharply in response to Russia's invasion of Ukraine. As of yesterday, it has shifted lower to a mere 25bp hike in March and 120bp in total by the December FOMC meeting.

However, the positive domestic growth assessment by Powell and the clear desire to get inflation under control shone through in today's testimony. He stated: "We understand that high inflation imposes significant hardship, especially on those least able to meet the higher costs of essentials like food, housing, and transportation. We know that the best thing we can do to support a strong labour market is to promote a long expansion, and that is only possible in an environment of price stability." This has given the market a little more confidence in the tightening path and while it is still priced for a March 25bp hike we are now back up to 140bp of tightening by year-end.

Case for tighter monetary policy remains strong

Given the situation in Ukraine, this will remain highly volatile and our own forecasts are subject to a huge degree of risk. Russia's actions undoubtedly make the outlook far more uncertain and pose clear challenges for the global economy through higher commodity prices, more strained supply chains, and heightened anxiety. Nonetheless, the US economy is growing strongly, has very low unemployment, and is experiencing inflation at 40-year highs. The US is also more economically insulated from the crisis than Europe through less direct trade and banking linkages and by virtue of being an energy producer.

It is obviously difficult to call how the geopolitical backdrop will evolve, but our central case for now is the Fed responds with six hikes this year and announces a gradual, passive run-down of its \$9tr balance sheet in late 2Q.

Author

James Knightley

Chief International Economist

james.knightley@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>.