SKIPPING THE PAUSE

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At last month's FOMC meeting, the Fed hit the pause button for the first time since it began raising rates in March of last year. As a result, speculation began to intensify about what the policy maker's next move could be or whether it would take a breather for a while and see what 500 basis points (bps) worth of rate hikes has done to the economic and inflationary setting. Well, after hearing from Chairman Powell in the weeks following the June Fed gathering, one could be forgiven for thinking the FOMC may just be "skipping the pause" part and getting right back to rate hikes.

The question I keep coming back to is whether Powell & Co. are seriously considering raising the Fed Funds Rate as soon as this month's policy meeting or was the Chairman just trying to send a message to the markets—the Treasury arena in particular—that yields needed to be adjusted for a higher for longer scenario and not rate cuts. If you think about it, if it was the "messaging" option, why not just emphasize that rate cuts are off the table and not even being considered? Well, Powell essentially did say that and took it to the next level by saying two more rate hikes "may be appropriate."

Now let's turn our attention to last week's developments. The Fed Chair has been consistently mentioning how the majority of policy makers see two more rate hikes this year, as evidenced by the shift in the "dot plot" at the June FOMC meeting. In other words, the Fed's median estimate for Fed Funds has been increased by 50 bps to 5.60% as compared to the prior projection in March. However, Powell went even further at last week's European Central Bank forum in Sintra, Portugal, when he said he wouldn't take consecutive rate increases off the table, presumably at the July and September Fed convocations.

So, let's summarize: the Fed went from pausing its rate hikes in June to now potentially raising rates at each of the next two scheduled FOMC meetings. I'm sorry, but I can't help but wonder why did the Fed even pause then? I mean, if you're apparently leaning in the direction of raising rates one or two more times, why not just rip the band-aid off and do it in June and go from there? From an economic/inflation data perspective, did the policy maker really think that much was going to change between meetings?

Conclusion

Needless to say, these developments only highlight our thoughts that volatility is going to remain elevated in the money and bond markets. In addition, it also underscores our point of preferring to be late rather than early to the duration party. Stay tuned…it looks like "Fed-watching" is going to be an intriguing endeavor for the second summer in a row.

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DEFINITIONS

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Basis point : 1/100th of 1 percent.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Inflation : Characterized by rising price levels.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Dot Plot : a chart based on the economic projections of the Federal Reserve board members that illustrates their views on the appropriate pace of policy firming and provides a target range or target level for the federal funds rat.

Volatility : A measure of the dispersion of actual returns around a particular average level.