Fed raises interest rates with a 25 basis point increase

MARKETS & INVESTING

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Indications from the central bank are that its tightening cycle is *drawing to a close.*

- At the March 2023 Federal Open Market Committee (FOMC) meeting, the Federal Reserve (Fed) raised the federal funds rate by 25 basis points (bps).
- The Fed's pace has slowed in recent months, with 25 bps adjustments in its January/February and March meetings.
- The market is forecasting one additional hike during the May FOMC meeting.
- Fed Chairman Jerome Powell reinforced that the Fed is committed to reaching its 2% rate of inflation target.
- This increase brings the Fed's cumulative total increase to 475 bps since March 2022 and raises the federal funds rate to 4.75%-5.00%.

One year into a tightening cycle designed to curb rising inflation, the Fed indicated that its rate hikes may soon be drawing to a close after a 25 basis point increase was announced at its March 22 FOMC meeting.

“Although the markets have been volatile – both up and down – in the aftermath of the decision and chairman’s press conference, overall, the messages should be viewed as reassuring to the markets,” said Raymond James Chief Investment Officer Larry Adam. “The important messages include that the banking system is ‘sound and resilient,’ employment is healthy, the disinflation story remains intact, and most important, the end of the tightening cycle is near.”

“The Fed’s forward guidance was more dovish as the Fed said, ‘some additional policy firming may be appropriate’ versus the previous message of the Fed ‘anticipates that ongoing increases in the target range will be appropriate.’ The main reason: The recent events in the banking sector are likely to further weigh on both growth and inflation and cause the Fed to end its tightening cycle,” noted Adam.

There had been speculation leading up to this meeting that the Fed would resist making another rate increase following a wave of volatility in the banking sector, but the central bank sided in favor of continuing its path. With a strong labor market and resilient economy, it’s clear that the Fed has more work to do to reach its 2% rate of inflation target line.

“The rate increase decision by the Fed is a clear indication that they believe that managing the risks of the recent banking sector turmoil is different than managing the risks for inflation and considered that further action on rates was necessary to continue to combat inflation,” said Raymond James Chief Economist Eugenio Alemán, Ph.D.

The ninth consecutive rate hike brings the Fed’s cumulative total increase over the last year to 475 bps and raises the federal funds rate to 4.75%-5.00%, the highest range since 2007. The 425 bps of adjustments in 2022 represented the most aggressive start to a tightening cycle in the last 40 years. That said, the pace of rate adjustments has slowed in 2023 to a total of 50 bps so far.

The Summary of Economic Projections (SEP), which includes the “dot-plot,” or an estimate of where interest rates may be during the next several years, has the median federal funds rate at 5.1%, unchanged from the December SEP estimate while the median for the federal funds rate for 2024 was increased, from 4.1% in the December SEP to 4.3% in today’s SEP. The median for the federal funds rate for 2025 remained at 3.1%, unchanged from the December SEP estimate.

“There were several dots for 2023 that called for the federal funds rate to be as high as 5.9%. For the years after 2023, the spread in the dot-plot remained high, which means that there is considerable uncertainty on the path for interest rates going forward,” said Alemán.

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