CURRENT MARKET NEWS

Fed Chairman Powell doubles down on inflation fighting

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Fed Chairman Powell took a hawkish track yesterday in the press conference Q&A following a rather middle-of-the-road FOMC (Federal Open Market Committee) written statement release. As already expected by the markets, the Fed is almost certain to begin raising interest rates in March. Beyond that very near-term expectation, however, the remainder of the Q&A communication firmly suggested that the Fed will respond to continued inflation pressures with a faster pace of rate hikes and balance sheet reductions.

In the Q&A, Chairman Powell indicated the primary risk facing the Fed is inflation staying higher or becoming more persistent. With his labeling of the labor market as "tremendously strong" and growth "well above potential", those portions of the Fed mandate appear to be satisfied in the eyes of the committee. When asked about recent stock market volatility, and whether that was alarming or could change policy, Chairman Powell responded that the Fed's focus was on the real economy and that financial conditions mattered only insofar as they affected price stability and maximum employment.

Notably, Chairman Powell repeatedly referenced how different today's inflation, employment, and growth environment is from that of the last rate hike cycle that began in 2015. The message seemed clear enough – do not expect the same slow approach as back then. He also referenced the much larger size of the Fed's balance sheet and indicated there remains a "substantial amount of shrinkage" to be done. It seems that shrinkage could begin as early as the summer.

As Chairman Powell pushed through the Q&A, the equity market went from solidly positive to negative, the yield on the 10-year Treasury Note challenged the recent highs, and the dollar gained smartly against major currencies. A classic reaction to Fed hawkishness. The Fed Funds Futures market similarly increased the number of interest rate hikes it is pricing in from four to somewhere between four and five by year end.

This degree of hawkishness will likely contribute to equity market volatility until it becomes clear that inflation is coming down and the Fed can ease off the brakes. The good news remains that growth prospects look stable, consumer and corporate balance sheets are healthy, the labor market is strong, and inflation should (ironically) start to come down of its own accord anyway. There remains a viable path toward market stability, but the risk of Fed over-tightening has increased despite being just at the cusp of the tightening cycle.

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