May 2023

Last hike?

UBS Asset Management I The Fed raises rates for the tenth consecutive meeting

The US Federal Reserve raises rates and signals potential pause

The Federal Open Market Committee (FOMC) of the US Federal Reserve hiked rates at their 3rd May meeting by 25 bps, moving the fed funds target range to 500 bps – 525 bps from 475 bps – 500 bps. The vote for the rate hike was once again unanimous at 12-0.

The most notable change in the meeting statement was the removal of language that "some additional policy firming may be appropriate." Instead, the Committee maintained the language that they will take into account the cumulative impacts of tightening thus far, the lags with which policy changes have on the economy, and broader economic and financial developments. Markets interpreted this as the Fed perhaps signalling that this may be the last hike before a pause. The FOMC also removed language that monetary policy was trying to get to a rate level that was sufficiently restrictive. This may imply that the Fed views the current stance of monetary policy after this move as being "sufficiently restrictive." The FOMC also acknowledged that tighter credit conditions "are likely" to weigh on economic activity, hiring, and inflation, but that the extent of these effects are "uncertain."

During his press conference, Fed Chair Powell avoided being explicit that this was the last rate hike, instead saying the Fed will be data dependent. He also suggested that if the FOMC's forecast comes to bear, then rate cuts wouldn't be warranted later this year. Speaking on economic conditions, Chair Powell noted that the labor market still remains tight and that inflation has a "long way to go" to return to the 2% target.

On the debt ceiling, Chair Powell said that it's "essential" for the debt ceiling to be raised in a timely way and that a US Government default would be unprecedented and the consequences to the US economy could be "quite adverse."

He was also asked about the reverse repo program (RRP) and if any changes had been considered. He said they looked at it "very carefully", especially in light of the recent banking stress and the outflows from bank deposits. He mentioned that the RRP was not a contributing factor to banking system stress, highlighting that balances have been steady and that the program is helping to "keep rates where they're supposed to be."

Fed funds futures are now pricing in essentially no change (only 1.2 bps worth of hikes) for the next FOMC meeting on 14th June with a year-end rate of 4.26%, which remains well below the Fed's median dot of 5.125%. The S&P 500 finished the day -0.70% and, and the 2yr Treasury fell by 17 bps to 3.81%.

We continue to position our UBS money market funds to take advantage of this rate hike and for the broader market environment.

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UBS Asset Management (Americas) Inc., 787 Seventh Avenue , New York, NY 10019
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