Don't Relax Now. The Fed Isn't Done Raising Rates

Don't expect an actual pause in rate hikes for now.

By Erik Sherman

As many had predicted and markets priced into their activity, the Federal Reserve's Federal Open Market Committee (FOMC) cut the pace of interest rate hikes by half, to 0.25 percentage points, on Wednesday.

But don't pop the champaign bottle yet. The Fed was clear that the rate hikes will continue on, although it hasn't specified a time, and that means a continuation of uncertainty and the difficulty of attaining price discovery.

While the FOMC noted that inflation had slowed, clearly that hasn't yet been enough.

"The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time," a Fed statement noted. "In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans."

"This is a micro-step toward a pause which will not likely happen until later in 2023," said Jeffrey Roach, chief economist for LPL Financial, in a statement. "When I compare the current statement with last year's, I conclude the days of any hikes greater than 25 bps are over for this cycle. It seems the Committee no longer worries about the 'pace' but now focused on the 'extent' of future increases."

As Bill Adams, chief economist for Comerica Bank, noted in emailed remarks, "the Fed is still guiding expectations toward a terminal rate of at least 5.00%-to-5.25%, not the 4.75%-to-5.00% range that markets have been contemplating as the peak in recent weeks."

An area of potential danger is that markets become too sure that they know what the Fed will ultimately do. There was an immediate rally in equity markets. But the central bank is keeping in mind that things could get worse.

"The Fed is worried about a reacceleration with inflation, which is justified considering how far inflation is from target," said Edward Moya, senior market analyst at OANDA, in an email. "The Fed is clearly telling markets that they are willing to overshoot here to make sure they conquer inflation."

"The Fed is going to hike at least two more times, taking the overnight rate above 5%, contrary to what many have been saying during the rally, and once they pause, they are going to keep interest rates constant until at least the end of this year (also contrary to what most people are saying)," added Chris Zaccarelli, chief investment officer for Independent Advisor Alliance.