NEWSQUAWK PREVIEW: FOMC decision due Wednesday 4th May 2022 at 19:00BST/14:00EDT; Powell presser at 19:30BST/14:30EDT

The FOMC is seen lifting its target Fed Funds Range by 50bps to 0.75-1.00% in its second hike post-COVID. The Fed is also set to formally announce its balance sheet reduction plans (quantitative tightening, 'QT') with maximum monthly caps expected at USD 60bln and 35bln of Treasuries and MBS, respectively, with a three-month phase-in. While there are some glimmers of peaking inflation, the Fed will not want to leave it to chance and has work to do in bringing policy up to neutral (largely seen a 2.25-2.5%, potentially lower when including QT) so as not to worsen supply-side constraints with excess demand. Powell's presser/Q&A will be gauged for guidance on the rate path with estimates looking at another 50bps hike at a minimum, and debate on whether /when the Fed will hike rates above neutral into 'tight' policy, something which markets are pricing in for as soon as Q4 - Powell will likely stick to his "if appropriate" at the time stance. While some Fed officials have touted a potential 75bps hike, it's not seen as the consensus but remains a tail risk. If Powell keeps the possibility open for future meetings, markets have shown they are happy to test that boundary.

RATES: After the 25bps lift-off in March, rates are expected to be lifted by another 50bps, taking the Federal Funds Target rate to 0.75-1.00%, an increment that money markets have priced with a probability over 90%; there is also some pricing for a 'wildcard' 75bps hike. Chair Powell recently said it's "appropriate to move a little more quickly" in the Fed's efforts to get to a neutral rate (which the March forecasts project is between 2.0-2.5%) to restore price stability, and that a 50bps rate rise will be on the table in May. While some regional Fed presidents (Bullard, Evans, and Daly) have appeared receptive to a 75bps hike, that has not resonated more broadly among officials, and no Board Governor has touted the prospect. Fed's Mester (voter), the last speaker before the FOMC blackout, pushed back on a 75bps increment, saying an outsized move on rates was "not the right way to go", with a preference for more consistency. Since then, data has seen Q1 GDP fall into contraction–largely influenced by a chunky deflator and trade imbalances, rather than slowing consumer demand–while the Q1 Employment Cost Index rose to by lofty +1.4% Q/Q (+5.7% annualised vs pre-COVID +3%), stoking some concerns over a future wage-price spiral. On the other hand, core CPI was softer than expected in March, echoing the CPI report and giving credence to some of the "peak inflation" calls. Altogether, it seems unlikely that the Fed consensus will have moved into the 75bps camp post-blackout given the bank's aversion to surprise (and potential financial instability), especially when factoring in the prospects of a formal balance sheet reduction announcement (QT) being made alongside the rate hike.

RATE PATH: The May statement is expected to reiterate that the FOMC "anticipates that ongoing increases in the target range will be appropriate", and traders will be looking to Chair Powell's post-meeting press conference for further colour, given that the Fed will not be updating its economic projections at this meeting (next updated in June). Powell has already pledged to lift rates “expeditiously”. A poll conducted by Bloomberg suggests economists expect to see a 50bps rate rise in both May and June, and are then expecting hikes to come in 25bps increments, taking the FFR target to 2.25-2.50% by the end of the year and peaking at 2.75-3.00% in December 2023. Money markets, meanwhile, are pricing rates reaching neutral as soon as September and then ending the year in restrictive territory above neutral (2.75-3.00%). If Powell showed any openness to a 75bps move, it would likely embolden market pricing for the meetings ahead, but analysts generally agree that the Committee is likely to pursue 50bps moves into the second half of the year if it wanted to get to neutral faster. Note: most Fed officials have advocated lifting rates to the neutral level, and then deciding at that point if it were appropriate to hike above neutral, a zone economists say will be restrictive for economic activity; meanwhile, hawks like Bullard have argued that there is already a need to lift rates above neutral, and he has pencilled in rates rising to 3.00-3.25% by year-end.

BALANCE SHEET: Officials are also cognizant of how the bank can generate additional tightening by reducing the size of its balance sheet. These quantitative tightening (QT) plans are set to be formally announced at the May meeting. Minutes from the March meeting suggest officials have coalesced around maximum monthly caps of USD 60bln and 35bln for Treasuries and MBS, respectively, with a three-month phase-in period. The economist consensus is for the reductions to start in May at USD 20bln and 15bln in Treasuries and MBS; however, remarks from dovish Fed Vice Chair Brainard suggest that a June start is possible. Given the monthly variance in the amount of maturing securities from the Fed's portfolio, any shortfall in meeting the monthly caps would be met by running off the difference from its USD 300bln+ T-Bill portfolio, according to the March meeting minutes. Any commentary or guidance on outright asset sales will also be a topic of interest for traders; the consensus is that outright MBS sales will occur at some point further down the line in an effort to reduce the Fed's footprint in the housing market, something which Fed Chair Powell may weigh in on in his presser/Q&A.

ECONOMY: In light of advanced Q1 GDP dipping into contractionary territory (-1.4%), the Chair will likely be asked about the extent to which the Fed is comfortable tightening policy in the face of slowing growth, and if it would be prepared to engineer a recession to manage price pressures. Powell will likely point to the large trade imbalance and deflator obfuscating the strong underlying consumer metrics in the GDP report, as well as referencing back to signs of strength in other data points such as retail sales, industrial production, and employment data. While Powell could allude to signs that inflation may have peaked (citing the core CPI and PCE misses, for instance) and uncertainty spurred from the Ukraine invasion, as well as China's lockdowns as causes for concern on the outlook, there are plenty of domestic data points that will keep the Fed's plans to remove accommodation on track. Wage-price spiral concerns–the so-called second-round inflationary impacts–are at the forefront of officials' minds after the Q1 Employment Cost Index jumped; additionally, there remains untapped excess savings built during the pandemic, and a potential shift in spending from goods to services (keeping inflation buoyed), which all point to further demand pressure risks. The Fed will be eager to rein in that excess demand so as not to accentuate the supply-side constraints.