PREVIEW: FOMC Minutes due Wednesday 25th May 2022 at 19:00BST/14:00EDT

SUMMARY: The minutes will help to gauge Committee members' thoughts on how far rate hikes will need to go, and their views of the neutral rate, which is generally seen somewhere between 2-3%, although many speakers have suggested it is hard to pinpoint the exact level as it is an estimate and will depend on how inflation reacts to the ongoing normalisation and to what extent supply-side pressures ease. The FOMC has broadly pushed back on the idea of a 75bps rate hike, including some of the hawks. The Fed is expected to raise rates by 50bps for the next couple of meetings (although markets are pricing 50bps rate rises at the next three meetings), before returning to more measured 25bps increments, and traders will be looking to the minutes for more colour. Meanwhile, once rates have hit neutral and likely above, some participants–like the hawkish Bullard–have already started talking about potential rate cuts in 2023 or 2024; therefore, any views on this within the minutes will also be eyed (it is worth stressing that Bullard wants rates at 3.5% by year-end, so it would be easing from very tight conditions). With the balance sheet rundown commencing in June, with a three-month phase-in via caps of USD 60bln and USD 35bln for Treasuries and MBS, respectively, any discussion around the balance sheet caps will be eyed while the topic of MBS sales will also be key, although the FOMC has told us that these are not under consideration at the minute, but could be a possibility in the future.

MEETING RECAP: The Federal Reserve's May policy announcement was in keeping with market expectations. It lifted the Federal Funds Rate target by a 50bps increment to 0.75-1.00%, while the statement continued to suggest the Committee anticipates that "ongoing" rate rises will be appropriate. At the post-meeting press conference, Chair Powell leaned back against calls that the Fed could lift rates in 75bps increments, stating that the Committee was not actively considering hikes of that magnitude, and arguing that 50bps moves at the next "couple" of meetings was likely to be appropriate. The Committee also announced a phased-in start to balance sheet normalisation beginning in June (some were expecting the process to begin in May); the maximum monthly caps will start at USD 30bln and USD 17.5bln for Treasuries and MBS respectively, ramping up to USD 60bln and USD 35bln over three-months. Powell said the effects of balance sheet reduction were uncertain, but there are estimates that it could deliver the equivalent of a 25bps hike over the course of a year, perhaps biasing the neutral rate to the low-end of forecasts. The Fed alluded to the negative GDP print in Q1, saying that although overall economic activity edged down, household spending and business fixed investment remained strong. Chair Powell is also confident that the Fed can engineer a soft economic landing as it lifts rates in the face of a growth slowdown, though he constantly caveated the challenges the central bank would face in that endeavour. Powell was dismissive about the prospects of an outright recession, and he said that there was nothing in the economy that suggests it was close to a recession, though that was not to mean there will not be some slowing of growth. On the notion that the Fed could lift policy above estimates of the neutral rate – something economists say will begin to restrict economic activity from the current accommodative stance – Chair Powell repeated that the Committee would not hesitate to hike above that level (which the Committee sees between 2-3%), but said that this was not a decision to be made now, implying he was in the camp that favoured raising rates to neutral and then assessing the magnitude to which further rate rises were needed.

RECENT COMMENTARY: Since the meeting, financial markets have seen episodes of sharp risk-off amid concerns about global inflation and a slowing growth impulse. Some had expected Fed officials to dial down hawkishness in order to cushion the unwarranted tightening of financial conditions engineered by the sharp risk aversion, however, key officials have not gone down this route; hawks like Bullard appear to be in line with the consensus of 50bps rate rises at the June and July meetings, while doves like Evans do not appear to be wavering as risk assets slide, all suggesting that the central bank would stay its course on tightening policy for now. One of the key emerging debates seems to be focussed on what the Fed will do when it gets rates to neutral: will it pause hiking and assess the situation, or will it revert to shallower 25bps incremental rate lifts. Chair Powell reiterated the case that the Fed would continue with hikes until inflation was back at target. Given the Fed's challenge in dealing with high inflation, this line from Powell is to be expected – backing away from it now risks undoing the initial work in lowering inflation expectations. However, analysts will be looking to the minutes for any hints on how the Fed could inject dovishness while staying the course regarding normalisation; analysts have speculated that the Fed might be able to project some dovishness by alluding to a lower terminal rate in this cycle, pausing when rates get to neutral; it could even suggest that the need for a larger 75bps hike was lower. Note, Fed's Bostic recently spoke of a "pause" after two to three 50bp hikes, although he is the only member of the FOMC to suggest such a time out. Meanwhile, Fed's Bullard, who wants rates at 3.5% by year-end, spoke of potential rate cuts in 2023 or 2024. However, given he sees the neutral rate at 2% and expects rates of 3.5% will be needed, it would be easing from very tight conditions.

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