newsquawk

Preview: FOMC rate decision due 18:00GMT/14:00EDT on Wednesday 22nd March 2023

THE MARCH DEBATE: The recent financial stability concerns among some regional US banks have been largely driven by a rapid rise in interest rates as the Fed normalises monetary policy aggressively to bring down inflation. This has raised some concerns around the health of the banking sector, and the FOMC's March meeting will be used to gauge the extent to which officials see economic confidence being affected, as inflation continues to run hot despite some recent cooling. Accordingly, the debate around the March meeting is whether the Fed continues to lift rates to tackle above-target inflation, or whether it pauses to assess the financial market fallout. "The question for central banks who are desperate to rein in inflation is how much the crisis will affect economic confidence and if so, will it help in their quest to rein in inflation?" Analysts at Societe Generale write, adding that "markets responded with a resounding yes."

MARKET EXPECTATIONS: Money market measures are currently pricing an 80% implied probability of a 25bps rate rise to 4.75-5.00%, and a 20% probability of an unchanged rate decision. After some of the firm January economic data (released in February) and commentary from Fed Chair Powell, there was an expectation that the Fed could move rates higher by 50bps at this meeting, but this is no longer the case. Analysts at Goldman Sachs told their clients that in light of recent stress in the banking system, it was no longer expecting the FOMC to deliver a rate hike at the March meeting, noting the considerable uncertainty about the path beyond March. The bank also estimated a tightening in lending standards due to the industry stress would be equivalent to a quarter or half-point increase in the Fed's benchmark rate.

STATEMENT/POWELL: Within the statement, analysts will be looking to see if the Committee repeats its guidance that an "ongoing increase 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% over time." A survey by Bloomberg suggests that most think that this guidance will be reiterated, although around one-third of those surveyed expects the FOMC to tweak this line in a dovish manner; if this change does materialise, traders could take it as a sign that the Fed's resolve in keeping rates higher for longer is easing. Meanwhile, regarding the tone of Fed Chair Powell at his pos-meeting press conference, the Fed boss is facing a tricky balancing act between restoring financial stability without diminishing its objective of bringing inflation back down to target. Societe Generale writes that "the Fed must err on the side of caution, and this means toning down the hawkish narrative until confidence in bank liquidity has been restored."

TERMINAL RATE EXPECTATIONS: Money markets are pricing in 35bps worth of tightening by May, and then price that the central bank will begin the process of loosening policy with rate cuts, with almost three 25bps cuts priced through the end of this year. This would also confound the guidance offered by Fed Chair Powell at his March dual-testimonies to lawmakers, where he suggested that the Fed's forecast for the terminal rate could be lifted from its current 5.1% level when the projections are updated at the March confab. UBS explains that if there is uncertainty in the financial system, demand for liquidity automatically tightens liquidity, and when the demand for money increases, increasing money supply through some liquidity mechanism is then entirely appropriate. "Central banks can tighten monetary policy in these circumstances, and the Federal Reserve will probably do so this week," UBS Wealth Management said, "international liquidity demand can also be met without a change to domestic policy, hence the extension of Dollar swap lines to global central banks. This is a standard play of past liquidity shocks. However, UBS Wealth Management also adds that "while the near-term monetary policy may be independent of the shifts in liquidity demand, this independence cannot last indefinitely," noting that "bank lending conditions have tightening for several months in Europe and the United States, without a more dramatic economic downturn; however, accelerated tightening of bank lending conditions will accelerate the downturn." The Swiss bank adds that "near-term policy tightening is likely, but the longer-term policy path becomes a lot less certain."

BANK STRESSES: Weekly Fed balance sheet data revealed that lending at its discount window spiked by a record amount. The central bank's 'emergency loans' stood at USD 318bln (vs USD 15bln W/W). Its new BTFP programme total outstanding amount was USD 11.9bln as of March 15th; the Fed said there was USD 15.9bln total collateral under the new bank term funding programme; the Fed's balance sheet jumped to USD 8.69tln on March 15th, from USD 8.39 tln on March 8th, the highest level since November; other credit extensions rose to USD 142.8bln as of March 15th from zero on March 8th. Capital Economics said that it showed the scale of the stress in the financial system, and was a far more severe liquidity crunch than at the start of the pandemic (emergency loans peaked at USD 130bln then), and not far off the financial crisis peak of USD 437.5bln in 2008. CapEco argues that as a result of the USD 318bln of emergency loans, reserve balances increased by USD 440bln in the week, to USD 3.444tln; the consultancy says that this has basically reversed all the Fed's QT efforts. "The size of the spike in the Fed's emergency lending underlines that this is a very serious crisis in the banking system that will have significant knock-on effects on the real economy,"

Copyright © 2023 Newsquawk Voice Limited. All rights reserved.
Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.
newsquawk.com · +44 20 3582 2778 · info@newsquawk.com

CapEco wrote. For reference, according to a poll conducted by Bloomberg, analysts estimate that the size of the Fed's balance sheet will shrink from around USD 8.3tln currently to USD 8.0tln by June, before falling to USD 7.5tln by the end of this year, and USD 6.8tln by the end of 2024; of those surveyed, around 40% think the Fed will begin selling MBS holdings in Q3 of this year.

QUANTITATIVE TIGHTENING: Some analysts will be watching if the FOMC makes any announcement with regards to its programme of quantitative tightening, particularly in light of the effective balance sheet expansion over the last week. Credit Agricole explains that “if there is take-up in the recently announced Bank Term Funding Programme, this would mean an increase in the size of the balance sheet, which could at least partially offset QT,” though the bank believes that the two programmes can co-exist.

LIQUIDITY: Over the weekend, the Fed announced that it and the BoC, BoE, BoJ, ECB, and SNB coordinated action to enhance the provision of liquidity via the standing USD liquidity swap line arrangements, and would increase the frequency of 7-day maturity operations from weekly to daily, through to at least the end of April. These will serve as a tool to backstop liquidity conditions to ease strains in global funding markets, which will help to mitigate the effects of such strains on the supply of credit to households and businesses.

DATA: After the slew of hot January data, the February data was eyed to see if that hot trend had been maintained. Fed Chair Powell in his testimony to congress alluded that if the data comes in hot, the FOMC is open to accelerating the pace of hikes once again, implying a 50bp hike was on the cards. However, with the banking crisis unfolding the market no longer looks for a possibility of a 50bp hike and the February data did not sound alarm bells for an overly-hot economy. The February CPI data was in line with expectations although the core metric M/M was slightly hotter than forecast and the Fed-eyed core services ex-housing ticked up, but the headline services ex-housing slowed. The PPI report was much cooler than expected across the board, while the University of Michigan consumer inflation expectations saw notable declines; the 1yr fell to 3.8% from 4.1% and the 5-10yr fell to 2.8% from 2.9%. Elsewhere, the jobs report saw an uptick in the unemployment rate although the headline jobs were above expectations, but cooler than the hot print in January. Given data was on the cool side, and the ongoing banking crisis, it has been argued there is little need for the Fed to inject extra hawkish stimulus, albeit inflation is still at elevated levels, it is showing signs of slowing and cracks are starting to emerge as a result of the Fed's tightening process implying the economy is not as robust as initially thought.

Disclaimer

The information contained within this document has been prepared and issued by Newsquawk Voice Limited (**"Newsquawk"**) on the basis of publicly available information and other sources believed to be reliable. Whilst all reasonable care is taken to ensure that the facts stated are accurate, neither Newsquawk nor any of its directors, officers or employees shall be in any way held responsible for its content or your use of it. Neither the provision of any content herein nor anything on our website or any other media we use is intended to, and should not be construed as, providing advice and/or enticing an offer or solicitation to invest in, buy or sell securities or other financial instruments.

Copyright © 2023 Newsquawk Voice Limited. All rights reserved.

Registered Office One Love Lane, London, EC2V 7JN, United Kingdom · Registered Number 12020774 · Registered in England and Wales.

newsquawk.com · +44 20 3582 2778 · info@newsquawk.com