JSB Capital Management, LLC

Pro-active Wealth Management

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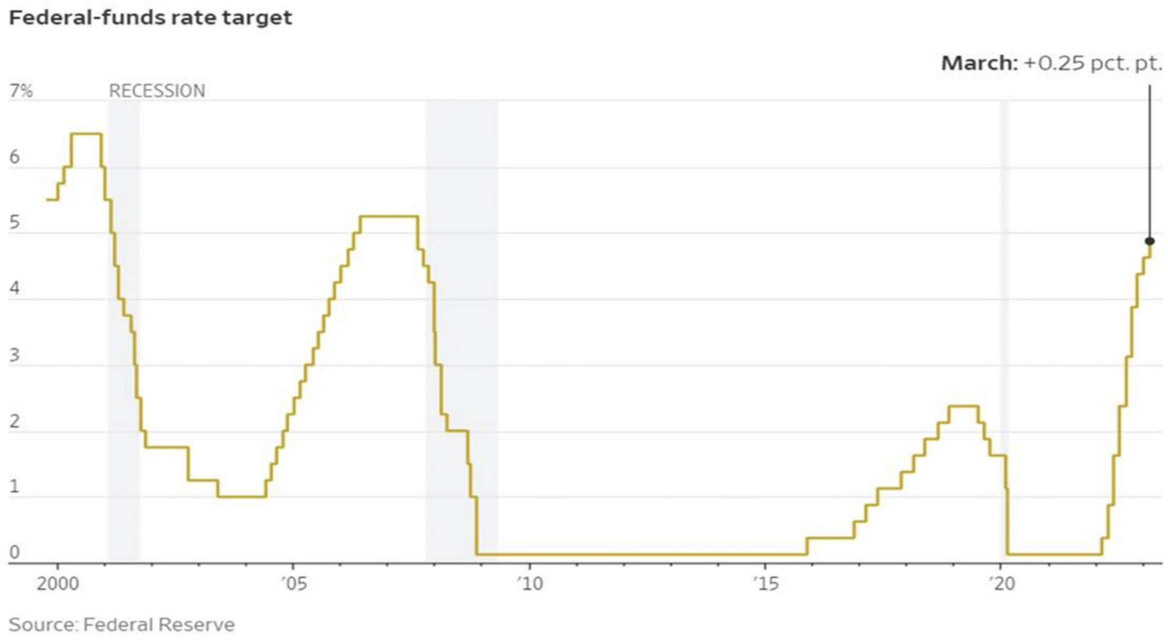
In spite of the daunting headline news and subsequent panic that Silicon Valley Bank and Credit Suisse created about ten days ago, the Federal Open Market Committee (FOMC) announced a mostly anticipated minimum interest rate hike this morning of 0.25%. Before the banks collapsed, the consensus was that the FOMC would raise interest rates by ½ of a point (0.50%) and probably announce their intention to continue with additional rate increases for the next several meetings.

Federal Reserve Bank Chairman Powell

The latest move lifts the target for the federal-funds rate to a range of 4.75% to 5%, marking the ninth increase in about a year.

In the closely observed post-meeting policy statement the FOMC hinted that the days of consistent increases in the federal funds rate could be winding down. In previous statements the FOMC has included a sentence that its policy-making committee expected "ongoing increases" in the Federal Funds rate would be appropriate. That language, combined with the projections of the Fed Funds rate by the participants, consistently implied that the central bank believed there were at least two more rate increases to come. However, today's statement modified the projection. In its place, the FOMC voters stated that the "Federal Open Market Committee will closely monitor incoming information and assess the implications for monetary policy." In addition, "The Committee anticipates that some additional policy firming may be appropriate," the statement continues. Mr. Powell encouraged the attendant press corps to focus on the words “some” and “may” when forecasting future FOMC moves.

The chart below indicates the aggressiveness of the FOMC with nine rate hikes in a row:



Now that today’s rate increase brought the bank’s target for the federal-funds rate to a range of 4.75% to 5%, the Fed's latest Summary of Economic Projections (SEP), also released after the meeting, shows the median expectation among Fed officials is that the rate will rise to 5.1% by the end of this year. This is known as the “terminal rate” which is thought to be a rate that is neither stimulating nor suppressing economic growth.

In his prepared remarks Mr. Powell noted that the data on the job market and inflation since the FOMC’s previous meeting came in hotter than expected. As a result, the Chairman said, the committee had been considering larger increases in interest rates at this week’s meeting and reiterated previous guidance that additional rate hikes were likely for later this year. But because the banking turmoil is likely to result in a tightening in financial conditions, Powell said, officials settled on a quarter-point increase at this meeting. They meet again on May 2 and 3.

Powell Addresses Silicon Valley Bank Disaster

Mr. Powell began his press conference by acknowledging the recent turmoil will likely result in a drag on the availability of credit and thereby slow the U.S. economy. He stated that “recent developments are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring, and inflation. The extent of these effects is uncertain.” He went on to state that these conditions essentially act as an additional rate hike and that it further supported their decision to implement the smaller increase today.

“The U.S. banking system is sound and resilient,” the statement reads. The statement didn’t give many clues to the Fed’s next moves, instead stressing a dependence on the incoming economic data and presumably further developments in the banking sector.

Federal Reserve Chairman Powell attempted to calm frazzled bank depositors and panicked investors by calling Silicon Valley Bank an “outlier” in his remarks and said that the Fed was conducting a review of its apparently negligent oversight of the bank. “At a basic level, Silicon Valley Bank management failed badly,” Powell said. He further criticized the lack of prudent asset management by not hedging risks in long-duration securities (bonds of ten or more years to maturity) on its balance sheet, and then further criticized their being forced to sell those underwater securities when faced with a historic bank run. Also, he emphasized that the bank’s troubles aren’t a sign of wider failures to come in the U.S. banking system.
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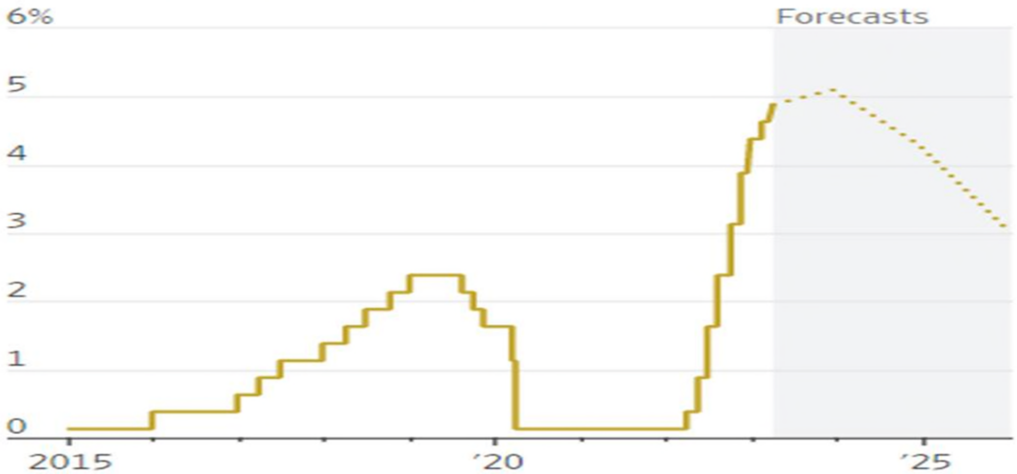
Mr. Powell said that the central bank’s vice chair for supervision, Michael Barr, was conducting a probe into how the failure was allowed to happen and what the central bank may have missed. “The question we were all asking each other over that weekend was ‘How did this happen?’” Mr. Powell said.

What Does the Future Look Like Now?

Today's interest rate decision follows Moody's ominous announcement that it had downgraded its outlook for the U.S. banking system from "stable" to "negative." In spite of that, the Fed Chair said emergency actions by the Fed and other regulators over the past few weeks have been effective (more money could easily be printed, as usual), and that the central bank was closely monitoring the Regional Bank situation in particular. He downplayed the issues as being limited to “a small number of banks.” Powell emphasized that the banking system was “sound and resilient.” It wasn’t reported as to whether he had his fingers crossed under the dais.

Prior to the collapse of the various banks, the stock market in particular had been rising somewhat in anticipation of the FOMC easing back on their aggressive interest rate hikes and even hoping (dreaming) for a potential interest rate easing process to begin in the summer. The chart below depicts the popular (bullish) forecast for just such an interest rate path which if implemented could provide a significant boost to future stock prices and possibly stimulate the economy as well.

Federal-funds rate target



Note: Forecasts are median forecasts for 2023, 2024 and 2025 year-end values.
Source: Federal Reserve

During the highly volatile question and answer period Mr. Powell directly addressed several reporter's questions about the forecasts for the Fed to ease. He directly and emphatically shot that notion down stating that the possibility of a rate cut this year was nowhere on the Fed's radar. As a result, the stock markets turned from fairly large rallies into a plunge during the last hour or so of the trading day and closed at their lowest levels of the session. Nothing in today's market action changes the outlook for the near-term and no modifications to the portfolios are required.

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