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Skip or pause

In the past two weeks, Federal Reserve (Fed) Chair Jerome Powell delivered speeches to clarify the Fed's policy outlook. In his statements, Powell said that most Fed officials see the need for further rate hikes this year. It therefore appears that the Fed skipped on tightening before increasing rates again. This was in contrast to the market perception that the Fed would pause to allow policymakers to assess incoming economic data that would determine their next actions.

Long way to go

On June 14, the Fed announced that it was keeping its policy rate at 5.25%. This came after an unprecedented pace of tightening and consecutive rate hikes amounting to 500 basis points in the Fed's last ten policy meetings. Following the rate decision, Powell delivered a statement to explain the latest action. On June 21, he delivered a testimony to the US Congress which reiterated and clarified the Fed's policy stance. Below are some of the important quotes from Powell's recent statements.

- Inflation remains well above our longer-run goal of 2 percent.
- Inflation has moderated somewhat since the middle of last year. Nonetheless, inflation pressures continue to run high, and the process of getting inflation back down to 2 percent has a long way to go.
- It will take time, however, for the full effects of monetary restraint to be realized, especially on inflation.
- Nearly all FOMC participants expect that it will be appropriate to raise interest rates somewhat further by the end of the year.
- Reducing inflation is likely to require a period of below-trend growth and some softening of labor market conditions.
- For the end of this year, the median projection is 1/2 percentage point higher than in our March projections.

Head fake

In light of easing inflation and an imminent global slowdown, investors had been expecting the Fed to pause from tightening and become more dovish. Though the Fed kept its policy settings in its last meeting, Powell left the market confounded when he signaled two more potential rate hikes for this year.

In a Q&A session with reporters, Powell explained the Fed's outlook even further. He likened the Fed's job to a car ride where the driver has to slow down as he approaches his destination. Powell said, "We're at least close to where we think our destination is, and it only makes common sense to move at a careful pace." Powell added, "Overwhelmingly people on the Committee do think that there's more rate hikes coming but we want to make them at a pace that allows us to see incoming information."

Divergent policies

Since the US dollar is the primary global reserve currency, the Fed's actions can directly affect the direction of the currencies and economies of other countries. Policymakers from other countries would often have to react to what the Fed is doing. This time, however, central banks are acting based on their own agenda and the needs of their respective economies. While the Fed skipped on tightening, Europe, England, Norway, Switzerland, Canada, and Australia hiked their policy rates as they attempt to tame elevated inflation. On the other hand, China cut its lending rates to prop up its slowing economy, causing the Chinese yuan to plummet. Meanwhile, the Bangko Sentral ng Pilipinas (BSP) maintained policy settings as it implemented a pause in tightening. The divergent policies of global central banks have caused investors to become more tentative and confused, prompting them to reassess their outlook and strategies.

BSP pause

While the Fed is looking to skip before resuming rate hikes, the BSP has implemented a pause in tightening. In an interview last week, BSP Governor Felipe Medalla said that the BSP has done enough to tame inflation. He added, "There is little reason to raise, there is little reason to cut." In a recent interview, BSP Deputy Governor Francisco Dakila, Jr said that "policy actions of the Fed will, of course, remain relevant" but these would be "less of a factor in the BSP's decision-making as domestic considerations carry more weight."

Uncertainty and volatility

In the past two weeks, investors were puzzled by the Fed's policy statements. According to Powell, inflation is not coming down as fast as expected, and the Fed sees the need for incremental rate hikes to bring down inflation. This fanned fears of a deep global slump as many major economies are already slowing down or contracting. Meanwhile, monetary policies started to diverge as central banks act based on their own agendas and the needs of their respective economies. This leads to an uncertain interest rate outlook amid an ongoing global economic slowdown. Consequently, fears of a deep economic recession have resurfaced and this can result in continued market volatility. Incoming economic data and the next moves of central banks bear watching as these can provide some guidance and clarity on the direction of the stock market and the global economy.