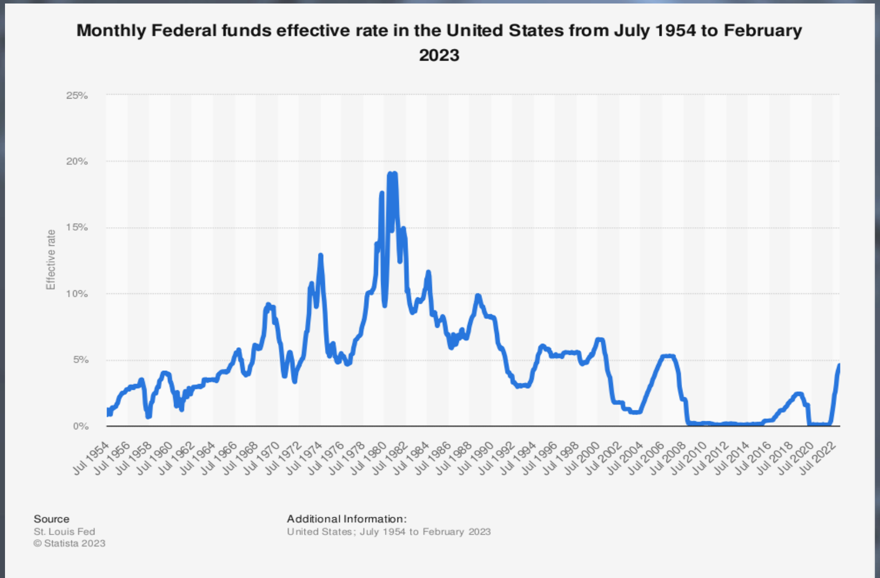

FED
Pause
Underway



What is a "Fed Pause"?

- **U.S. Federal Reserve (Fed)**, the nation's central bank is tasked with determining the policies regarding the interest rates, in order to manage the economy, either by increasing the rates to curb the inflation or lowering the rates to promote growth.
- **An Interest Rate Pause** happens when Fed decides to switch direction from a contractionary (tight) policy and keep the rates unchanged from past month. This is typically followed with a switch to an expansionary (loose) policy, which is called a "pivot".
- Such a pause typically happens when economic conditions have fundamentally changed in such a way that the Fed can no longer continue its prior policy stance of increasing rates.
- Although the rising interest rates was effective in controlling the inflation, it is also reducing the corporate profit margins, putting pressure on lenders to a point of causing multiple bank collapses, driving up the cost of mortgages and the living costs, therefore raising the likelihood of a recession.
- According to CME Fedwatch tool, traders see a 76% probability of central bank holding rates at **5%-5.25%** range on 14th of June.

Why is Fed Increasing Interest Rates?

Fed Main Rate: 3.25%			
Implied Probability of Rate Move (Fed Funds)			
Meeting Date	% Hikes (+) or Cuts (-) Discounted	Implied Rate Change (bps)	Implied Effective Fed Rate
11/2/2022	303%	0.756	3.836
12/14/2022	547%	1.368	4.448
2/1/2023	699%	1.746	4.826
3/22/2023	762%	1.905	4.985
5/3/2023	783%	1.958	5.038
6/14/2023	772%	1.93	5.01
7/26/2023	749%	1.873	4.953
9/20/2023	721%	1.801	4.881
11/1/2023	668%	1.671	4.751
12/13/2023	624%	1.559	4.639
1/31/2024	587%	1.467	4.548
75-bps rate hike discounted for November 2022			

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
May 3, 2023	+25	5.00% to 5.25%
March 22, 2023	+25	4.75% to 5.00%
Feb 1, 2023	+25	4.50% to 4.75%
Dec 14, 2022	+50	4.25% to 4.50%
Nov 2, 2022	+75	3.75% to 4.00%
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.50%
June 16, 2022	+75	1.50% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

- The Fed lowered the fed funds rate to zero during the **Covid-19 economic shutdowns of 2020** in order to avert a complete economic collapse.
- Prices rose throughout 2021 as a result of a combination of factors; **supply chain disruptions** brought on by the pandemic, pent-up consumer demand, historically low unemployment, and financial market circumstances.
- At first, Fed officials contended that rising prices were only temporary and would go away on their own when the economy recovered. But by the beginning of 2022, it was obvious that inflation was far worse than anticipated.
- The Fed finally started raising interest rates in **March 2022**, starting with a **25-basis point increase**. With this shift in tactics, the Fed switched from a loose to a restrictive monetary policy.
- Sadly, prices continued to rise, forcing the Fed to raise rates by **50 basis points in May** and **75 basis points in June**— **the biggest rate increase in 28 years!**
- The consumer price index (CPI), one of the key indicators of U.S. inflation, **increased by 9.1% in June 2022** despite multiple rate rises, the highest year-over-year increase in more than four decades.
- In order to control the peak inflation, the central bank continued with additional **75 bps** rate increases in July, September, and November. Yet with CPI showing signs of slowdown, rate increases were slowed to **50 bps** in December and further down to **25 bps** in February 2023.

Consumer Price Index (CPI) as the Primary Indicator

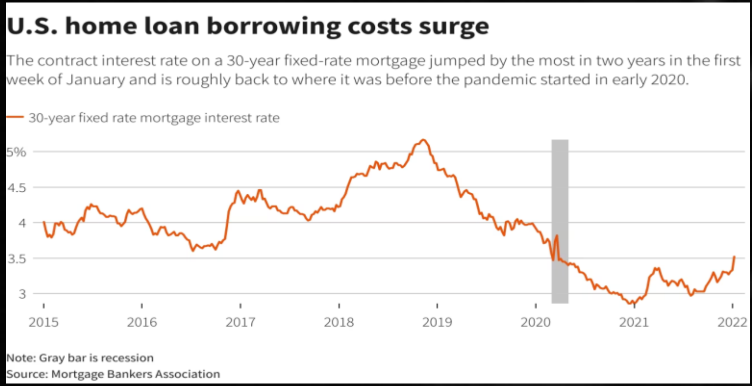
Release Date	Time	Actual	Forecast	Previous
Jun 13, 2023 (May)	08:30		4.1%	4.9%
May 10, 2023 (Apr)	08:30	4.9%	5.0%	5.0%
Apr 12, 2023 (Mar)	08:30	5.0%	5.2%	6.0%
Mar 14, 2023 (Feb)	08:30	6.0%	6.0%	6.4%
Feb 14, 2023 (Jan)	09:30	6.4%	6.2%	6.5%
Jan 12, 2023 (Dec)	09:30	6.5%	6.5%	7.1%
Dec 13, 2022 (Nov)	09:30	7.1%	7.3%	7.8%
Nov 10, 2022 (Oct)	09:30	7.7%	8.0%	8.2%
Oct 13, 2022 (Sep)	08:30	8.2%	8.1%	8.2%

The CPI's year-over-year growth rate has decreased to **4.9% as of May**. The Fed's tightening appears to be bringing down inflation and reached their initial target of **5.0%**, but there is still some way to go before it achieves its paltry **2% PCE inflation objective**.

The CPI data in November has shown that aggressive policies so far have been consistent in controlling the inflation and maintaining a decline. However, its effects on stock market so far is not negligible, especially in the banking sector, so Fed is expected to ease on their policies soon.

Rising interest rates have particularly taken a heavy toll on the banking sector and caused the **2023 Banking Crisis**, where three small - to mid-size U.S. banks have collapsed, which started with the failed **Silicon Valley Bank (SVB)**, when a bank run was triggered after the sell-off of the Treasury bond portfolio with a large loss.

Banks hold various assets in their portfolios; including government bonds, corporate bonds, and mortgage-backed securities. When interest rates rise, the value of these fixed-income securities tend to decrease. If banks need to sell these assets before maturity, they may face capital losses. This can negatively impact their profitability and overall financial position.



A high interest rate and high inflation also affects mortgage payers in several ways. With the increasing cost of borrowing, mortgage payers would face a higher payment in their monthly mortgage instalments, which also decreases the affordability of new homes, potentially causing a slowdown in housing market by affecting the buying power of individuals negatively.

Also, the incentive of refinancing mortgages, which allows borrowers to replace their current mortgage with a new one at a lower interest rate, would be less attractive since the potential savings from refinancing may not be significant enough to justify the costs involved.

Job Market Indicators that point towards Pause

History	Actual	Forecast	Previous
May 5, 2023	253K	181K	165K
Apr 7, 2023	236K	228K	326K
Mar 10, 2023	311K	224K	504K
Feb 3, 2023	517K	193K	260K
Jan 6, 2023	223K	200K	256K
Dec 2, 2022	263K	200K	284K
Nov 4, 2022	261K	197K	315K
Oct 7, 2022	263K	248K	315K
Sep 2, 2022	315K	295K	526K
Aug 5, 2022	528K	250K	398K
Jul 8, 2022	372K	260K	384K
Jun 3, 2022	390K	325K	436K
May 6, 2022	428K	390K	428K
Apr 1, 2022	431K	492K	750K

It's historically known that aggressive actions in interest rates to discourage borrowing would normally impact the labour market as companies pull back on their spending. This might also show an increase in lay-offs.

U.S Nonfarm Payrolls shown a steady increase in number of employees. This shows that policies so far have not triggered a large-scale job loss in the market or an economic contraction.

Even after millions of people lost their jobs at the start of pandemic, economy has since **regained all lost jobs**, adding hundreds of thousands more positions each months and maintaining an unemployment rate that is **close to a 50-years low**.

Unemployment Rate has remained in the **lows of 3.5%**, which was also commented as a "positive development" by **Fed Chair Jerome Powell**.

Release Date	Time	Actual	Forecast	Previous
Jun 02, 2023 (May)	08:30	3.7%	3.5%	3.4%
May 05, 2023 (Apr)	08:30	3.4%	3.6%	3.5%
Apr 07, 2023 (Mar)	08:30	3.5%	3.6%	3.6%
Mar 10, 2023 (Feb)	09:30	3.6%	3.4%	3.4%
Feb 03, 2023 (Jan)	09:30	3.4%	3.6%	3.5%
Jan 06, 2023 (Dec)	09:30	3.5%	3.7%	3.6%
Dec 02, 2022 (Nov)	08:30	3.7%	3.7%	3.7%
Nov 04, 2022 (Oct)	08:30	3.7%	3.6%	3.5%
Oct 07, 2022 (Sep)	08:30	3.5%	3.7%	3.7%
Sep 02, 2022 (Aug)	08:30	3.7%	3.5%	3.5%
Aug 05, 2022 (Jul)	08:30	3.5%	3.6%	3.6%
Jul 08, 2022 (Jun)	08:30	3.6%	3.6%	3.6%
Jun 03, 2022 (May)	08:30	3.6%	3.5%	3.6%
May 06, 2022 (Apr)	08:30	3.6%	3.5%	3.6%
Apr 01, 2022 (Mar)	08:30	3.6%	3.7%	3.8%

Release Date	Time	Actual	Forecast	Previous
May 31, 2023 (Apr)	10:00	10.103M	9.775M	9.745M
May 02, 2023 (Mar)	10:00	9.590M	9.775M	9.974M
Apr 04, 2023 (Feb)	10:00	9.931M	10.400M	10.563M
Mar 08, 2023 (Jan)	11:00	10.824M	10.500M	11.234M
Feb 01, 2023 (Dec)	11:00	11.012M	10.250M	10.440M
Jan 04, 2023 (Nov)	11:00	10.458M	10.000M	10.512M
Nov 30, 2022 (Oct)	11:00	10.334M	10.300M	10.687M
Nov 01, 2022 (Sep)	10:00	10.717M	10.000M	10.280M
Oct 04, 2022 (Aug)	10:00	10.053M	10.775M	11.170M
Aug 30, 2022 (Jul)	10:00	11.239M	10.475M	11.040M
Aug 02, 2022 (Jun)	10:00	10.698M	11.000M	11.303M
Jul 06, 2022 (May)	10:00	11.254M	11.000M	11.681M
Jun 01, 2022 (Apr)	10:00	11.400M	11.400M	11.855M
May 03, 2022 (Mar)	10:00	11.549M	11.000M	11.344M

JOLTs Job Openings; a survey done by **US Bureau of Labor Statistics** to help measure job vacancies by collecting data from employers about their businesses' employment, job openings and recruitments, also shows high numbers in job vacancies.

This might point out to high turnover rates, adding into the inflationary pressure since a high inflation adds to the wage pressure with an increase in labour cost for qualified candidates. High interest rates and rising wages contribute to increased production costs for businesses, which potentially would lead to higher prices for consumer goods and services.

What does it all mean for Stock Market?

- High interest rates are typically bad news for stock market, because of increasing cost of borrowing money. As companies stop borrowing, their growth is slowed down due to decreased investment and stock prices decline.

- In uncertain macroeconomic environments, investors tend to seek safe-haven in currencies and bonds, effectively selling off their stocks and staying in cash.

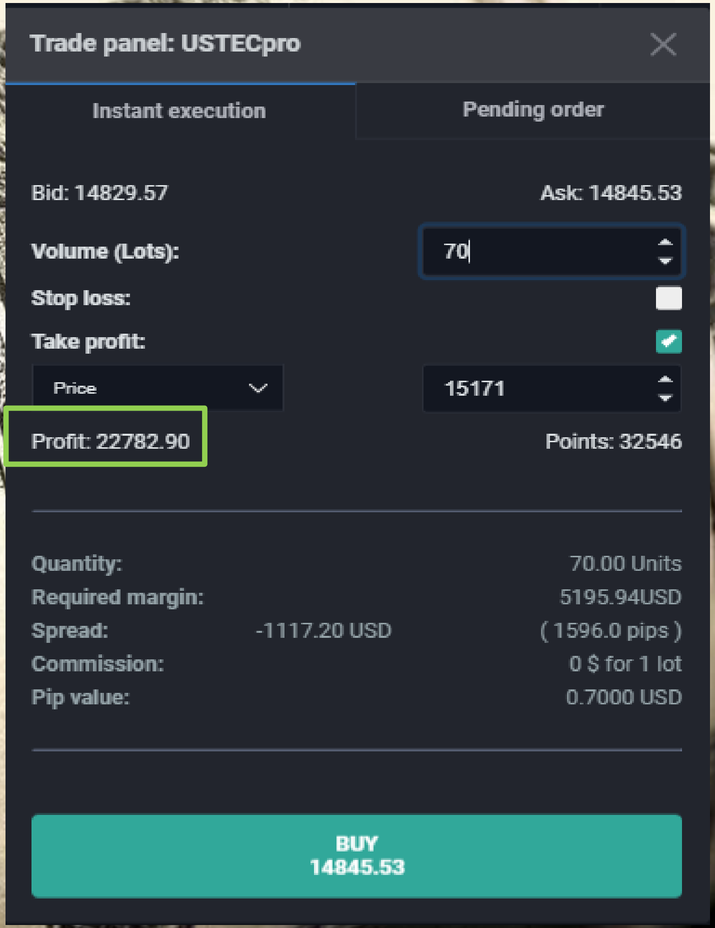
- This already caused index of S&P 500 to decline by **~27% at its peak in 2022**. Also, each Interest Rate hike has caused the value of index to drop by an average of **~4.14%.**

- So, a pause in Fed Interest Rate is expected to cause a surge in the S&P 500 and Nasdaq Indices, along with many of the growth stocks. This means an opportunity for investors to buy the stocks of most high potential companies with a discounted price, to generate returns in a short period.

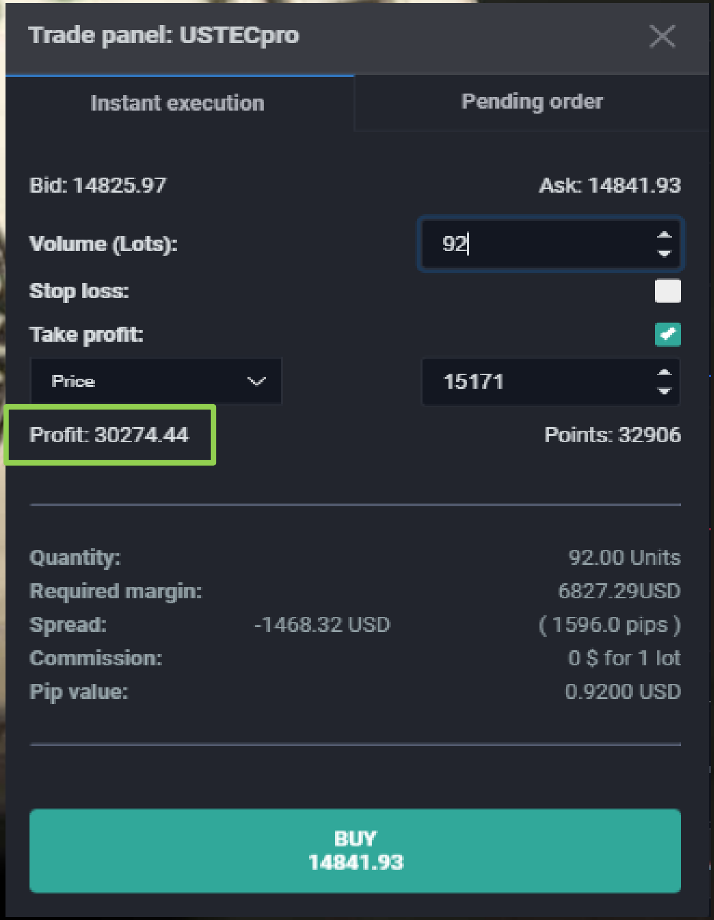
Fed-Pause – Trade Examples : Nasdaq (USTEC)

Investment of $50,000

Investment of $75,000



Investment of $100,000



Sources for Information

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Provided by ***Emir E***