Saying a long goodbye to Fed rate hikes

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Kristina Hooper
Chief Global Market Strategist

United States

I expect the Federal Reserve to raise rates one more time this week before finally ending this long and grueling rake hike cycle.

Japan

Many expect the Bank of Japan to alter its yield curve control policy, but I'm skeptical that it will happen at this meeting.

Europe and UK

There's more work to be done by central banks here as inflation problems persist in these economies.

Regular readers of this blog know that I'm a basketball mom. What you may not know is that this summer marked my daughter's last club season, as she is entering her senior year of high school. It's been a long season, but as I write this, I'm in Lancaster, Pennsylvania, for our last tournament. It's been a bittersweet weekend, marking the end of an era that began many years ago with our first club tournament in Illinois when she was in middle school. I'm feeling a wave of emotions — sadness that this chapter is ending and my little girl is truly growing up, combined with relief that our long, grueling and expensive season is finally over without many injuries (she broke her finger earlier this season but was able to avoid surgery with the help of intensive physical therapy). We team parents have been sentimental for months now – this is our "last this" and our "last that." In short, it has been a long goodbye.

I'm experiencing some of the same emotions with regard to the US Federal Reserve (Fed). This has been a long and grueling rate hike cycle. We've had just one major financial injury thus far — the regional banking mini-crisis — but we know the longer the rate hike cycle lasts, the greater the chance for more "accidents" and "injuries." And, because of the lagged effects of monetary policy, injuries can still occur after rate hikes end. In short, I've been waiting for the Fed to end its rate hike cycle for some time, so I would refer to the last several months as the Fed's long goodbye. I think this week will mark the last hike of this tightening cycle, even though the Fed may not say so. But in my opinion, it will be — and it needs to be. That's because the US is very clearly experiencing disinflation. If I were a country singer writing about the US rate hike cycle, I might title my next song, "How can I miss you if you won't go away?"

Major economies are on the disinflation journey

In fact, developed Western economies are in various stages of disinflation. For example, last week we learned that Canada's Consumer Price Index (CPI) fell to 2.8% year-over-year in June — a low not seen in more than two years — which was viewed as a "milestone moment" by Canada's finance minister. Inflation in Canada is lower than any other G7 economy, and it's finally back within the Bank of Canada's (BOC) 1% to 3% control range (2% is the target) after being outside that range for more than two years. Canada also saw progress with core CPI, although it remains above the BOC's control range.[1] It seems appropriate for the Bank of Canada to say goodbye to tightening soon as well.

Other major economies are on the disinflationary journey, although they have not made as much progress as the US or Canada, so it may take longer for their central banks to end their tightening cycles. Eurozone CPI for June was lower than expected, although core CPI remains more stubborn — which has been a common theme. But that is to be expected as core inflation tends to lag headline inflation. So, we will get European Central Bank and Bank of England meetings this week with rate hikes expected — but it's not going to be the end of the line for them. There's more work to be done because of when they started tightening and the extent of the inflation problem in their respective economies.

The real attention this week will be on the Bank of Japan (BOJ). Many are expecting some kind of alteration to the BOJ's yield curve control policy. While that is certainly a possibility, I'm skeptical that it will happen at this meeting.

Chinese unemployment presents a challenge to the economy

Just as strategists and economists seem to be becoming more optimistic about the US economy, they seem to be getting more pessimistic about the Chinese economy. In my opinion, the major difference is the employment situation in these economies. In the US, the labor market remains tight, although it is easing slightly. That has cushioned the Fed-induced slowdown, making it an anemic, job-full slowdown (in contrast to the anemic, job-less recovery following the Global Financial Crisis).

In China, unemployment — especially youth unemployment — is significantly higher. That is proving problematic, especially in terms of weighing down consumer sentiment. However, I believe it increases the likelihood of fiscal stimulus this year, which should be positive. Beyond China, I'm positive on Asia emerging markets, particularly Indian and ASEAN economies. Demographics is on the side of these countries, with strong household formation helping to drive consumer spending.

Earnings

Of course, no market commentary would be complete without mentioning earnings season. We are getting into the heart of earnings season, and I am paying close attention to the guidance we are receiving on earnings calls. More to come on this topic next week.

Going along for the ride

Finally, as you may know, I'm an aficionado of the movie "Jaws" and shark-related topics such as TV programming around "Shark Week." However, I must concede that this summer has been the summer of the sea otter. For those who haven't heard, there is a sea otter off Santa Cruz, California, who is stealing surfboards from surfers. While some have used verbs like "terrorize" to describe her actions, I've become a fan of this plucky sea creature, who has not been afraid to take advantage of opportunities as they present themselves. She seems wise beyond her years (she is estimated to be five years old) and has quickly learned how to evade the many attempts to capture her and re-home her at an aquarium. Most of all, I adore her because she really seems to enjoy riding on surfboards (and at times chewing them). May we investors take a page from her playbook and be good students of the market, take advantage of opportunities as they present themselves, and of course enjoy the ride.

Notes

[1]Source: Statistics Canada, as of July 18, 2023

Important information

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

All investing involves risk, including the risk of loss.

The Consumer Price Index (CPI) measures changes in consumer prices.

Tightening monetary policy includes actions by a central bank to curb inflation.

The Group of Seven, or G7, is an informal grouping of advanced democracies that meets annually to coordinate global economic policy and address other transnational issues.

ASEAN stands for the Association of Southeast Asian Nations, an intergovernmental organization of 10 Southeast Asian countries.

The eurozone is an economic and monetary union of European Union member states that have adopted the euro as their common currency.

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