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PHILEQUITY CORNER

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Higher and higher

Financial markets tumbled last week after the Federal Reserve's (Fed) latest policy meeting. Though the Fed kept its policy settings steady, Fed Chair Jerome Powell's statement was more hawkish than what investors had expected. The US dollar index (DXY) gained 0.4% since the Fed meeting last Wednesday. The S&P 500 fell 2.8% in three consecutive down days. Bonds tanked as US Treasury yields jumped to their highest levels since 2007.

One more time

In his speech, Powell noted that majority of FOMC members expect one more rate hike for this year. This dashed market expectations that interest rates have already peaked. Powell also said that the latest dot plot for 2023 and 2024 moved up by 50 basis points, indicating a more hawkish outlook. Below, we summarize important quotes from Powell's statement last week.

- "Looking ahead, we are in a position to proceed carefully in determining the extent of additional policy firming that may be appropriate. Our decisions will be based on our ongoing assessments of the incoming data and the evolving outlook and risks."
- "The process of getting inflation sustainably down to 2 percent has a long way to go."
- "We are **prepared to raise rates further if appropriate**, and we intend to **hold policy at a restrictive level** until we are confident that inflation is moving down sustainably toward our objective."
- "Majority of participants believe that it is more likely than not that it will be appropriate for us to **raise rates one more time** in the two remaining meetings this year."
- "If the economy evolves as projected, the median participant projects that the appropriate level of the federal funds rate will be 5.6 percent at the end of this year, 5.1 percent at the end of 2024, and 3.9 percent at the end of 2025."
- "Compared with our June Summary of Economic Projections, the median projection is unrevised for the end of this year but has **moved up by 1/2 percentage point at the end of the next two years**."

BSP: rate hike is on the table

Last week, the Bangko Sentral ng Pilipinas (BSP) announced that it is also keeping its policy rate steady. However, the central bank upgraded its 2023-2024 inflation forecasts to reflect the impact of weather disturbances, higher crude oil prices, and the depreciation of the peso. In response to emerging threats to domestic inflation and the Fed's hawkish policy statement, BSP Governor Eli Remolona said that a rate hike is being considered for November. We list below some of Remolona's recent comments on policy and outlook.

- “Looking ahead, the BSP stands ready to resume its tightening actions in the face of upside risks and potential second-round effects that could dislodge inflation expectations.”

- “We’re ready to raise if the supply shocks are significant enough.“

- “Rate cuts this year 2023 are off the table. But rate hikes are not off the table. A rate hike is on the table for November. How big it will be will depend on the data.”

- “Average inflation is now seen to reach 5.8 percent in 2023 from 5.6 percent previously, while the forecast for 2024 likewise rose to 3.5 percent from 3.3 percent.”

- “The Monetary Board also reiterated the need for non-monetary interventions, including the temporary reduction of import tariffs with calibrated volumes and timely arrival of import commodities.”

Higher for longer

Powell spooked markets when he signaled that interest rates would move higher and higher and would stay higher for longer. Powell’s crucial comments on raising rates one more time, hiking rates further if appropriate, and holding policy at a restrictive level prompted heavy selling of most financial assets. While higher interest rates may be needed to bring down inflation, there are understandable fears that elevated borrowing costs would drastically slow the economy and trigger a painful recession.

Markets will turn when rates peak

Investors have started flocking to short-dated financial assets because of the high yields that they provide. These include short-term Treasuries, time deposits, and money market funds which have become attractive yield plays and alternative investments. The exodus from risk assets and the shift to short-dated instruments caused financial markets to plunge.

It remains to be seen how high interest rates must go before inflation sustainably comes down to comfortable levels. Based on past and recent market experiences, it is clear that keeping rates higher for longer or driving rates higher and higher would drag the performance of risk assets. Thus, we believe that markets will turn only when there are clearer signals that interest rates have peaked and rate hikes by central banks are over.

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