Opinion

FOMC Meeting: 50, 75 Or 100-Basis-Point Rate Hike?

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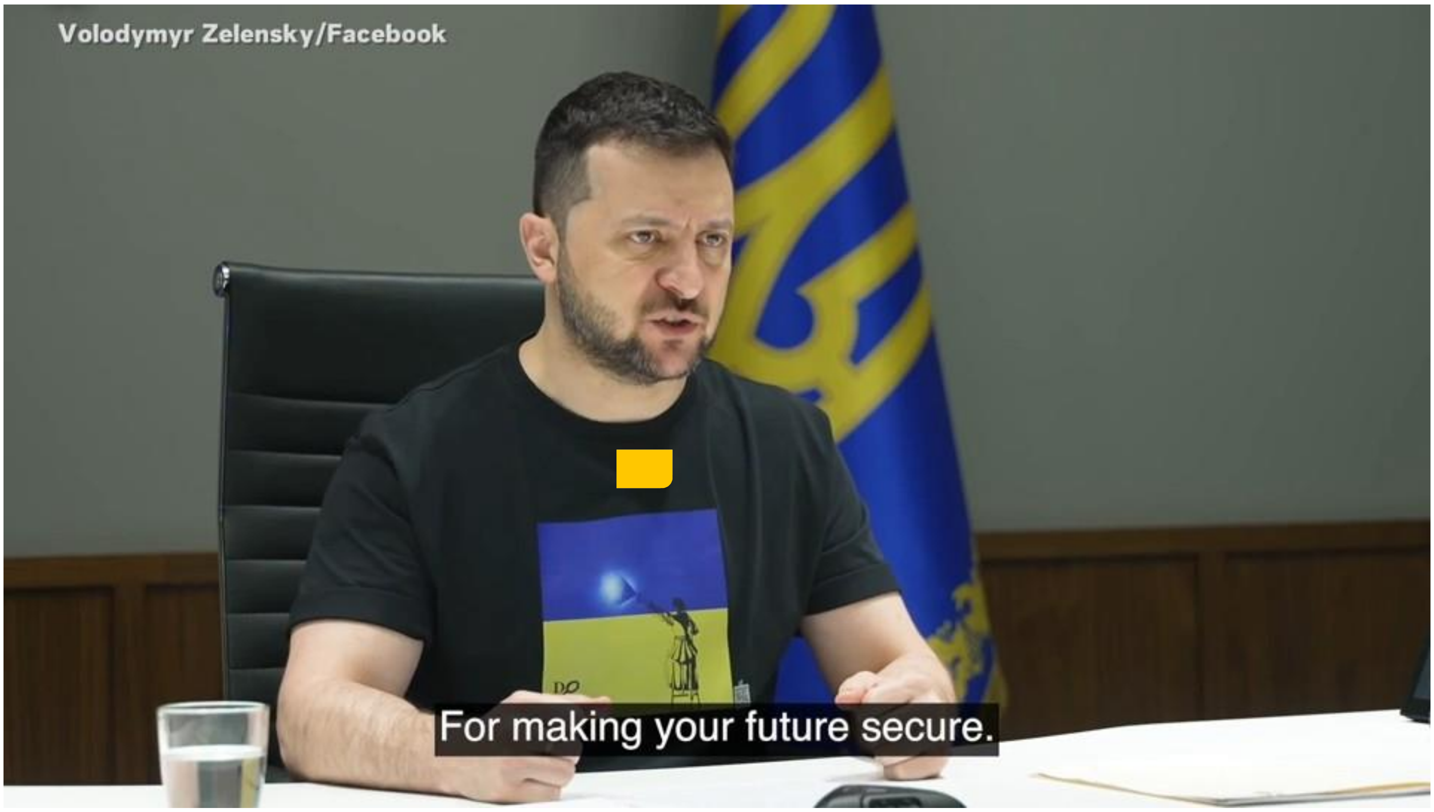
06/14/22 AT 1:41 AM



After selling off on the news of higher-than-expected inflation last week, Wall Street will be looking for clues this week to figure out how aggressive the Open Market Operations Committee (FOMC) will be in its efforts to bring the old villain under control.

“If there was any doubt on how aggressive the Fed is going to be with increasing interest rates, the answer has come in the form of the U.S. Consumer Price Index (CPI) data last week," Dan Raju, CEO of Tradier, told *International Business Times*. "Unfortunately, inflation in May reached 8.6%, the highest level in more than four decades. Such high inflation numbers will pressure the Fed to increase interest rates quickly to slow down rising prices."

By how much?

The consensus among Fed watchers is that the FOMC will raise its key Fed Funds rate — a critical short-term rate — by 50 basis points, with some Fed watchers predicting a 75-basis-point hike. And some rumors circulated on Wall Street Monday, calling for 100-basis points.

"I think what's more likely is the Fed continues to try to talk down inflation by warning they will continue to raise rates until it cools while also continuing with 50 bps rate hikes for a longer time than previously anticipated to meet that goal," Austin Litvak at O'Brien Wealth Partners told IBT. "Financial market conditions have tightened meaningfully so far this year in anticipation of Fed tightening, but there is a lag in the time it takes for interest rate hikes to have an impact on actual economic activity, such as consumer and business demand. Some components of CPI — such as service prices — are also lagging data."

But judging from the performance of the U.S. Treasury market on Monday, where 10-year bond yields climbed to 3.35%, the highest they have been since 2011, the bond markets expect a more decisive action from the Fed, perhaps 75 or even 100 basis points. That would certainly send a strong message to the bond market that the Fed is serious about getting "ahead of the curve" in the fight against inflation.

Still, the prospect of such decisive action doesn't seem likely, according to CIO Tom Siomades.

"This is a weak-kneed Fed, and 75 basis points this week would be bold for them — they have been behind this for well over a year," he told IBT. "They will not go strong because they also need support from the administration in the form of a fiscal plan that reduces government spending, which is not on the table. So we are in for elevated levels of inflation and a desperate Fed trying to catch up. It is hard not to expect all this to end in a recession sooner than later."

Robert R. Johnson, CEO of Economic Index Associates and professor at Creighton University's Heider College of Business, likes the idea of the Fed taking decisive action, but he's concerned about the impact of such action, too.

"By raising interest rates, the Fed is attempting to send a strong message that it is serious about fighting inflation," he told IBT. "The problem is that if that message is too strong, the cure could be worse than the malady."

Frank Sorrentino, chairman and CEO of ConnectOne Bank, sides with the consensus 50 basis points hike, but he will be watching the Fed's guidance closely.

"I also think we will hear some language about looking forward, and they may start to taper down in terms of other interest rate hikes as there are already signs of a slow-down," he told IBT. "They're going to continue to ramp up and look at the data and I think they have a pretty well-thought-out plan but I would not be surprised to see the Fed back up a step or two at some point along the way because we don't know how exactly the economy is going to react to all of these different changes."

We'll know on Wednesday how far the Fed will go this time.