Basis Points – June 15, 2023

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Above the Fold

The Fed Pauses, Warns … Markets Shrug

After 10 consecutive months of aggressive rate hikes (the fastest pace since the 1980s), the Federal Reserve opted for a brief pause; unfortunately, more hikes are likely to follow. Most of the board members expect two more rate increases before year-end in their statement, so this rate plateau at a range between 5% and 5.25%, a 16-year high, might be short-lived. Fed officials revised their projections for both economic growth and inflation higher. They also marked down their estimates of how high the unemployment rate would rise this year. Put simply, they believe the economy will remain stronger, longer … and in turn, warrant further rate increases.

The projections showed 12 officials seeing rates rising to between 5.5% and 5.75% this year or even higher, implying two additional quarter point increases at any of four meetings remaining in 2023. Higher rates not only affect consumers, but also banks and commercial real estate, and Federal Reserve Chairman Powell did acknowledge the risks to all the aforementioned entities, alluding to the fact that we could see more risk and even systematic stress. Obviously, the risks are deemed to be acceptable, and the bank stress we've experienced is probably a key reason why the Fed is taking a momentary break here. Despite the specter of higher rates and potential economic stress, the stock market viewed the news as positive.

Three Things

CPI Cools Considerably, but There's Still Work to Do

The consumer price index (CPI) rose 4% in May, which is around half of last year's peak but still elevated. Remember that price appreciation is an ongoing phenomenon, meaning that prices have not actually fallen, they are just rising at a slower rate. The CPI reached a peak of 9.1% last June, and was down from April's 4.9% increase. The overall trend is certainly welcome and proof that the Fed's policies are working, but inflation is still double the Fed's target rate of 2%. Rates may still have to be higher for longer until that target is reached.

EVs Need Superfast Chargers …

Aside from more efficient and less costly battery packs (and the number of charging stations in general), one of the biggest deterrents for would-be electric vehicle (EV) buyers is the time it takes to recharge, which can still be up to hours long at Level 2 public chargers that deliver power at 7 to 19 kilowatts. Most EV charging takes place at home, but the government, along with The National Renewable Energy Lab and other national labs, are working to create fast, Level 3+ chargers that can "refuel" an EV in 15 to 40 minutes. Unfortunately, Americans are still likely years away from a complete solution.

Debt Ceiling Deal Floods Bond Market

With the debt ceiling deal behind us, America is free to take on more debt. The main way the country does this is by selling bonds. Unfortunately, nearly $1 trillion in U.S. Treasury bills that were "pent up" awaiting the deal are now hitting the market. Obviously, the country will need to continue selling bonds to keep the country's lights on, but some are concerned that the selling pressure could drive bond prices lower, sending yields (interest rates) higher. The country's cost to borrow has already soared to nearly 6% compared to the 0.1% it was paying just two years ago.

In the Know

A Beatles Reunion Album Courtesy of AI

It’s been more than 50 years since the Beatles released their final studio album as a group with the help of AI (artificial intelligence). The transformative band will release their “last record,” which was actually a partially completed demo that John Lennon was working on, according to Paul McCartney. The latest AI iterations have been able to perfectly reproduce John Lennon’s voice, down to the most minute intonations and nuances so he could virtually “sing” even though he’s no longer with us. With all the scary press swirling around AI, it’s nice to hear (literally) something positive.

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