

Research US

Fed review – A cautious 25bp hike

- **Fed hiked by 25bp in line with our expectations, but sent a dovish signal by emphasizing that Fed is ready to pause if credit conditions tighten markedly.**
- **We stick to our call for a final 25bp hike in May. We expect the Fed to maintain the policy rate at 5.00-5.25% through 2023.**
- **EUR/USD jumped to around 1.09 – the highest level since beginning of February**

The Fed's decision to hike rates by 25bp was widely anticipated by both the markets and economists ahead of the meeting. In line with our expectations, Fed made no changes to its QT, and the median 'dot' continued to signal Fed Funds Rate at 5.00-5.25% through 2023.

In the statement, Fed highlighted that 'Recent developments are likely to result in **tighter credit conditions** for households and businesses and to **weigh on economic activity, hiring, and inflation**'. Furthermore, the forecast for 'ongoing increases' in the policy rate was changed to 'some additional policy firming may be appropriate'.

The dovish wording suggests Fed wanted more room to react to the downside risks. Bond yields declined modestly and broad USD weakened, and all together financial conditions eased slightly to compensate for the perceived risk of tightening credit conditions.

For now, we remain cautiously optimistic that the banking sector's difficulties remain relatively contained. The real money gap remains positive, and **a temporary pause to the monetary policy tightening would simply prolong resolving the inflation issue**, in our view. As real money balance declines, bank deposits will fall as well. While from historical perspective it is unusual to see bank deposits outright declining, it is not an unwanted consequence of Fed's tightening, but rather a part of the solution to the inflation problem.

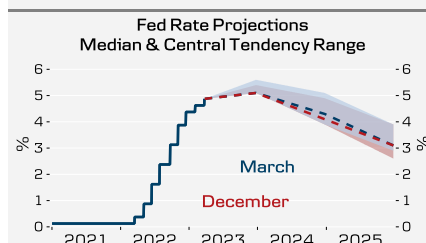
US banks' liquidity buffers relative to deposits remain healthy relative to pre-covid levels, also for small banks. The early data on the active use of Fed's emergency lending facilities suggests, that Fed's support is effectively shielding banks from liquidity problems.

The main uncertainty relates to the lack of timely data on how bank lending has reacted to the ongoing volatility. The most recent data covering the week leading up to the collapse of SVB suggests, that bank credit growth had remained strong in early March.

Broader market-based financial conditions indicators have not tightened markedly, especially after risk markets have recovered over the recent days. We will keep a close eye out for the incoming macro and bank lending data over the next weeks. Some early soft indicators, such as the Univ. of Michigan sentiment survey, did point to downside risks.

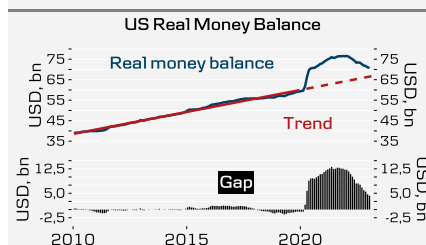
For now, we remain confident in our view that Fed will hike rates for the final time in May, and only cuts rates in Q1 2024. Market prices 50% probability for the May hike. Fed's median rate projection for 2024 rose to 4.3% (from 4.1%), underlining that hard data does not support early turn towards easing monetary policy. We also still see EUR/USD moving lower to 1.02 in 6M horizon. Relative rates have favoured EUR after the more hawkish ECB last week, but a prolonged rally in EUR/USD could support a renewed uptick in commodity prices and inflation expectations, and thus hinder a return to 2% inflation.

Rate projections were adjusted slightly higher



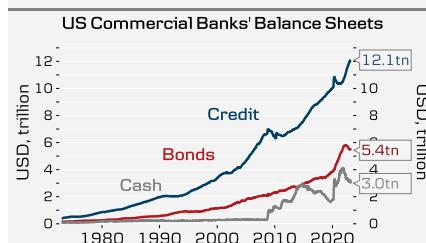
Sources: Macrobond Financial, Fed

Real money gap remains positive



Sources: Macrobond Financial, Danske Bank

Credit growth remained brisk leading up to the SVB collapse



Sources: Macrobond Financial, Fed

Analyst

Antti Ilvonen
+358 445 180 297
antti.ilvonen@danskebank.com

Director

Jens Nærvig Pedersen
+45 45 14 14 95
jenpe@danskebank.dk

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Antti Ilvonen, Analyst and Jens Nærvig Pedersen, Director

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issues covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Danske Bank is authorised by the Prudential Regulation Authority in the UK. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Danske Bank's research reports are prepared in accordance with the recommendations of Capital Market Denmark.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 22 March 2023 22:10 CET

Report first disseminated: 22 March 2023, 22:25 CET