MARKET PULSE

TRANSAMERICA ASSET MANAGEMENT, INC.

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JULY FED MEETING

On July 26, the Federal Reserve concluded its most recent meeting with the decision to raise the federal funds rate by 0.25% to a target range of 5.25–5.50%. Given this widely expected outcome against the backdrop of current economic and market conditions, we view the following points as relevant to investors:

- **The Fed's position on further rate hikes remains data dependent.** Aside from the fed funds rate itself, very little changed in the wording of the Fed's post-meeting statement, and, in his press conference, Chair Jay Powell reiterated the fight against inflation "still has a ways to go." He also emphasized that Federal Open Market Committee rate decisions would be data driven and made on a "meeting by meeting" basis. In hedging himself and the other members on future policy actions, Chair Powell further commented, "It's certainly possible that we will raise funds again at the September meeting if the data warranted … And I would also say it's possible that we would choose to hold steady."

- **Our best assessment is the Fed will conclude the year and this tightening cycle without further rate hikes.** It is our estimate at this time that the Fed will likely conclude this calendar year with the fed funds target range unchanged from its new level of 5.25%–5.50% and without additional rate hikes. Top criteria pertaining to this judgment include the lagging impacts of previous rate hikes since March of last year as well as the positive and potentially expanding levels of inflation-adjusted real interest rates. That said, we do not expect the Fed to reduce its target range on the fed funds rate until at least into CY 2024.

- **Lagging effects of previous rate hikes could impact economic growth in 2H 2023.** With 525 basis points (5.25%) of previous rate hikes over the past 16 months yet to be fully incorporated into the economy, we believe economic growth could weaken in the months ahead, contributing to future Fed decisions not to raise rates from present levels. It is important to recognize that standard economic thought typically believes it takes anywhere from 12–18 months for each interest rate hike to fully filter through the economy. This would infer less than half of all the Fed's tightening since March 2022 is currently being felt in day-to-day business activity, though that is likely to increase throughout the months ahead.

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- **We view the (inflation-adjusted) real rate of interest as being likely to expand in the months ahead, further supporting an end to the Fed's tightening cycle.** On July 28, the Bureau of Economic Analysis released the June Personal Consumption Expenditures (PCE) Inflation report, posting a year-over-year headline increase of 3.0% and a core (ex-food and energy) reading of 4.1%. This continues a declining trend since June 2022. More importantly, it expands the real interest rate (upper bound fed funds rate less core inflation rate) to 1.4% (5.5% less 4.1%), which, given the prospect of continuing declines in core inflation between now and year-end, could soon prove to be a wide enough spread for the Fed to hold tight at current rate levels and let the complete amount of previous hikes fully filter through the economy.

- **It is also important to note that the Fed will now have two full months of future economic data to review before the upcoming September meeting.** This will include not only two months of employment and retail sales data but also another PCE and two more consumer price index inflation reports, potentially allowing the real rate of interest to expand further prior to the Fed's next decision.

In summary, while speculation and conjecture on the Fed's future actions, or lack thereof, will undoubtedly continue in the months ahead and incoming economic data could create further market volatility, our best estimate remains that the Fed will conclude the year with a fed funds rate target range unchanged from current levels at 5.25%–5.50%.

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Tom oversees investment and mutual fund development and the sub-adviser selection process. He heads Transamerica Asset Management's investment thought leadership with advisors, clients, and media. Tom has more than 30 years of investment experience and has managed large mutual funds and sub-advised separate account portfolios. Tom holds a bachelor's degree in political science from Tulane University and an MBA in finance from the Wharton School at the University of Pennsylvania.

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