The U.S. Rate Hike and the Markets

What is the issue?

The US Federal Reserve decided to hike the benchmark interest rate for the first time since 2018 to control the rising inflation.

What did the Federal Reserve do?

- The US Federal Reserve has decided to hike the benchmark federal funds rate by 25 basis points to a target range of 0.25-0.5%.
- It also indicated that it will raise interest rates six more times this year, which could take the interest rates higher by 1.75% by the end of the year.
- The move is aimed at keeping a check on inflation which hit a four-decade high of over 7.5% even before the Russian invasion.
- With appropriate monetary policy, the Committee expects inflation to return to its 2% objective and the labour market to remain strong.

Will the move have effect on RBI?

- While there is no indication that the RBI will increase the key policy rates in its April policy review, it's likely to revise the growth forecast in the wake of the Ukraine war.
- It also remains to be seen whether the RBI will retain its accommodative policy stance.
- If the RBI hikes rates and tightens liquidity, markets are likely to take it as a negative.

What was the impact on the market behavior?

- **Market gains** - After the rate hike, Asian markets opened with big gains.
- **FPI-** Foreign portfolio investors (FPIs) have pulled out a net of Rs 1,36,487 crore from Indian equities since November 1.
- **Job growth**- The Federal Reserve has also said that job gains have been strong in recent months and the unemployment rate has declined substantially.
- **Crude oil price-** The crude oil prices, which hit a 14-year high recently, also came down sharply.
- **Peace talks**- Over the last few trading sessions, the markets have also been drawing comfort from the progress of talks between Russia and Ukraine.
- **Short term impact**- An interest rate hike in the US results in outflow of funds from emerging markets and into US treasury bonds thus weakening the equity markets.
- **Medium term impact**- However, the possibility of a peace between Russia and Ukraine, decline in unemployment rates in the US, could be beneficial for equity markets in the medium term and FPIs may start coming back in a few months.

What should investors do?

- Investors need to remain cautious of the volatility in the market and avoid aggressive lumpsum investments.
- It is better to go through a systematic investment plan (SIP), and into well-established blue-chip companies and large-cap funds.
- Experts say that while investors should not expect returns of the kind seen in the second half of 2020 and through 2021, they should enter the markets with at least a three-year horizon.

Reference

1. https://indianexpress.com/article/explained/explained-us-rate-hike-and-the-markets-7825192/