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Weekly Commentary

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Drama continued

I ended my last commentary with these words about the potential Federal Reserve rate hike: No doubt expectations will change this week as the situation develops. Well, that certainly was the case. On Monday, the day after the FDIC assigned the same fate to Signature Bank as it had to Silicon Valley Bank by placing it into receivership, the markets were thoroughly spooked. Projections for Fed action in the upcoming FOMC meeting this Wednesday were a coin flip between a 25 basis-point hike and no change—a profound shift from the half-point rise expected two weeks ago.

Then came the February Consumer Price Index (CPI) report Tuesday morning. Inflation modestly pulled back last month, with year-over-year headline and core growth of 6% and 5.5% compared to 6.4% and 5.6%, respectively, of January's data. But the monthly figures hardly budged, with headline still at 0.4% and core at 0.5%. The month-over-month numbers are the most relevant, and they are not falling. Markets seemed to snap out of it and recall that inflation remains much higher than the Fed wants, and the likelihood of a quarter-point hike took precedence. On Wednesday, however, the specter of bank failures rose again. This time, they came from across the pond, as Credit Suisse shares plunged on concerns it wouldn't be able to raise capital—even though it might not even need to. The "no change" camp grew in number.

Thursday whiplashed again, after the Swiss National Bank backed up Credit Suisse and the European Central Bank disregarded its situation anyway by issuing its own half-point hike. Not that the Fed follows other central banks, but the message reverberated that European policymakers believe inflation is more important than the problems the quick pace of tightening can create in the banking sector. As many—including us—think this is also the Fed's stance, consensus swung to a 25 basis-point hike. Although concerns continued about Credit Suisse [over the weekend, it was purchased by UBS], and several large banks pledged they would infuse capital into First Republic (a U.S. regional bank caught up in the fall of Silicon Valley Bank), the pendulum stopped swinging on Friday, with the 75% of the market expecting a quarter-point hike. Who knows what this week will bring. The release of the FOMC statement on Wednesday can't come soon enough.

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