Federal Reserve raises benchmark rate by 0.25 point despite bank turmoil

Markets expected the move, as inflation remains high even as rising rates put pressure on the financial system

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The Washington Post
March 22, 2023

The Federal Reserve raised interest rates by a quarter of a percentage point on Wednesday, moving forward with its fight against high inflation despite concern that its rate hikes may be fueling instability in the banking system.

Financial markets expected the move, which brings the Fed's base policy rate to between 4.75 and 5 percent.

Less than two weeks after the collapse of Silicon Valley Bank and Signature Bank jarred the nation's financial stability, policymakers said the banking system is "sound and resilient" in a statement released at the end of the Fed's two-day meeting. Still, events from the past few weeks could hamper the economy, which the central bank is still trying to slow down to control price increases.

"Recent developments are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring and inflation," the statement read. "The extent of these effects is uncertain."

The central bank is also facing questions about its regulatory oversight of SVB, as Washington tries to figure out whether the government could have prevented the turmoil in the banking sector.

"There is risk for the Fed here," Tim Duy, a Fed expert at the University of Oregon and chief economist at SGH Macro Advisors, wrote in an analyst note. "If the Fed hikes, it must be reasonably confident that regulators have ringfenced the banking problems. If the Fed hikes rates and bank failures multiply, the political fallout will be intense."

In a fresh crop of economic projections, officials penciled in one more quarter-point rate increase this year, though future moves depend heavily on how the economy behaves. Officials otherwise made small tweaks to their previous estimates from December. They now expect the unemployment rate to end the year at 4.5 percent (down from 4.6 percent the last time the bank made projections) and that the economy will grow by 0.4 percent this year (down from 0.5 percent they projected in December). Inflation will remain above normal levels through the end of 2023.

In the past few months alone, policymakers and economists have shifted their tunes — at times expecting an inevitable recession, no recession, persistently high inflation or an all-out banking catastrophe.

The markets were muted around midday. The Dow Jones industrial average dipped slightly in the red, falling 0.2 percent. The S&P 500 was down 0.2 percent, and the Nasdaq dipped 0.1 percent.

The Fed likes a plan. But recently its attempts to look ahead have been thwarted, by a global pandemic and war in Ukraine. Now the rapid interest rate increases of the last year are also contributing to a worrisome degree of instability in the financial system.

Bank failures don’t happen often. But it is even more rare for such a shock to happen in the days right before a Fed meeting, when officials are barred from speaking publicly about monetary policy. Typically, officials will use the weeks before a meeting to lay the groundwork for an upcoming rate hike, so that an official announcement is old news to the financial traders, economists and business executives who’ve been reading the Fed’s tea leaves.

But policymakers haven’t had time to set those expectations, making it one of the few, if only meetings since the Fed began raising rates that could bring a surprise.

The collapses of Silicon Valley Bank and Signature Bank prompted all-out interventions from the Fed and the Biden administration to stave off even bigger problems. The whiplash has focused new attention on financial regulation, especially since SVB imploded despite advance warnings and existing safeguards.

It has also put the Fed — which works hard to maintain its independence — under a harsh political spotlight. Earlier on Wednesday, Sens. Rick Scott (R-Fla.) and Elizabeth Warren (D-Mass.) unveiled legislation that would replace the Fed’s watchdog with an inspector general appointed by the president and confirmed by the Senate.

For more than a year, Democrats and Republicans have been at odds over the Fed’s policies, with Scott and Warren typically holding opposite views. But scrutiny of the central bank has taken on a new dimension as lawmakers of both parties ask whether the Fed failed in its supervisory duties. That’s coming at the same time that more officials, including Democrats on the Senate Banking Committee, are calling for an end to rate hikes, fearing repercussions for the job market.

“The recent bank collapses and regulatory failures by the Fed have underscored the urgent need for a truly independent Inspector General to hold Fed officials accountable for any lapses or wrongdoing,” Warren said in a statement.

The central bank’s meetings typically revolve around inflation, the job market and whether its approach to slowing the economy is working. The last time Federal Reserve Chair Jerome H. Powell appeared in public two weeks ago, he warned Congress that the central bank was seeing signs the economy was heating back up and might need to be more aggressive raising interest rates.

Perhaps the most consequential part of the day will be Powell’s news conference at 2:30 p.m. Eastern. He’ll likely get questions on every part of his job: deregulation of banking laws; what the Fed knew about SVB and when; whether he is concerned that more banking shocks are on the horizon; and whether he sees threats from Europe in the wake of Credit Suisses’s forced takeover. (Last week, the European Central Bank moved forward with a half-point rate hike despite the market upheaval.)

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He will also be asked to explain whether the Fed’s own interest rate fight is destabilizing parts of the economy, rather than just slowing it down. As the Fed raised rates repeatedly last year, the value of bonds issued at lower interest rates went down. SVB held an unusually high percentage of its assets in

Treasury bonds and other long-term instruments that suddenly lost their value, meaning the bank couldn’t easily sell them for what it would have needed to get cash to depositors who wanted to make withdrawals.

Powell will also be asked about the decisions to open a lending program to help keep money flowing through the banking system after SVB failed. On Sunday, the Fed also announced it was coordinating with other major central banks to ease strains in dollar funding markets, a major move that was previously employed in 2020 — when the pandemic started — and 2008, during the financial crisis that led to the Great Recession.

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