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# Volatility views

**Banking stress raises potential for volatile Fed decision**
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***Snapshot**: Recent market turmoil has options traders anticipating significant swings around this week's FOMC statement.*

# Banking stress raises potential for volatile Fed decision

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The Federal Reserve has spent the past year fighting inflation while trying to avoid tipping the US economy into recession. Now there's a new factor in the mix: the risk of intensifying stress in a banking sector already reeling from the quickest pace of interest rate hikes in decades.

That's setting up one of the most hotly-anticipated **FOMC decisions** in recent memory on March 22. The Fed must weigh whether to continue the battle against inflation or pause in light of the turmoil inflicted on the banking sector by rising rates.

While the start of the month saw many economists surveyed by Bloomberg predicting a 50 basis point hike this week, a majority now expect the Fed to raise rates by a quarter point. Some analysts expect policymakers to stand put or even cut rates. Last week's European Central Bank meeting muddied the outlook further. Investors anticipated a shift only for policymakers to stick to their original plan of a 50 basis point hike.

With the fresh uncertainty, options traders are bracing for volatility around the FOMC statement.

Here's what's currently implied from options prices in terms of excess event-related volatility for the March 22 policy statement, according to Optiver analysis. In other words, here's how much the event is expected to impact the following indexes and EUR/USD over and above normal volatility, 30 minutes after release of the statement.

| Event | Implied additional event volatility | | | |
|---|---|---|---|---|
| | SPX | NQ | ESX | EURUSD |
| March FOMC statement | 1.31% | 1.71% | 0.90% | 0.80% |

**Source:** Optiver. **Note:** SPX=S&P 500, NQ=Nasdaq 100, ESX=Euro Stoxx 50

For context, here's how much markets realized in the one hour following the release of the last FOMC policy decision on Feb. 1 (which includes the start of the press conference), when policymakers raised rates by 25 basis points.

| Event | Realized move over subsequent 1 hour | | | |
|---|---|---|---|---|
| | SPX | NQ | ESX | EURUSD |
| February FOMC statement | 0.61% | 0.75% | 0.56% | 0.26% |

**Source:** Optiver. **Note:** SPX=S&P 500, NQ=Nasdaq 100, ESX=Euro Stoxx 50

Market reaction could be significant should the Fed make a surprise move in either direction. **Should the FOMC keep interest rates unchanged, S&P 500 Index futures imply a positive reaction in the range of +1.5% to +2.5% for the trading day. Conversely, if the Fed hikes rates by 50 basis points, the S&P 500 Index could drop -2% to -3%, according to options prices.**

Investors will also be keeping a close eye on the press conference following the decision. While Fed funds futures have been pricing a terminal rate of 5.25%-5.5%, guidance could reveal a rate closer to 5% given recent developments.

To speak with Tom Borgen-Davis, contact media@optiver.com

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