

Economics

ECONOMIC FLASH!

economics.cibccm.com

December 13, 2023

Fed announcement: It's working!

Ali Jaffery ali.jaffery@cibc.com

As widely expected, the Fed opted to hold rates at its 5.375% mid-point. The only notable change to the statement was an indication that policy tightening is likely finished which Powell made fairly clear in his press conference. That's an important declaration given the uncertainty within the committee just three months ago, strong output and a still reasonably tight labour market. Perhaps more importantly, the FOMC would know that such a signal would have important implications for market pricing, a big question that when put to Powell, he chose to duck. Telling.

Looking ahead, the median voter expects policy to ease 75bps by end-2024 and a further 100bps by end-2025. That is an extra cut in 2024 and one less in 2025 than the September projection but with a lower starting point. By the end of 2026, the view is same as in the September SEP with the policy rate above neutral by about 50bps at 2.9%. The FOMC's dovish view is underpinned by a slightly faster deceleration of inflation but growth and unemployment mostly unchanged. Interestingly, the FOMC revised up its view of the long-run unemployment rate by one notch to 4.1% which would actually suggest there is more excess demand in the economy currently than they thought in September.

Not all those signals are fully aligned but it doesn't matter. The bottom line, as Powell repeated over and over, is the progress the achieved on inflation. A large part of this, as Powell alluded to in September and repeatedly re-emphasized today, was the strong rebound in the supply-side of the economy and the resolution of demand-supply imbalances. This positive force supporting growth and pushing inflation down will start to fade but the restrictive level of policy will likely be more than enough to keep inflation on an easy glide path down to the Fed's target, is how Powell seems to see the world. What was also striking was that Powell described the "last mile" as surprisingly not that difficult.

Nonetheless, we are not that far away from the Fed's view, with expectations of slightly less easing in 2024 and slightly more in 2025 to end up near the same level. However, we don't share the view that it will be as painless as FOMC sees it. While growth has been strong, the labour market has shown some signs of weakness with the unemployment rate ticking up and measures of slack moderating fast enough to merit the belief of an overshoot relative to where the SEP has them by end-2024. Underlying inflation measures of inflation such as Cleveland Fed trimmed mean measure and the Atlanta Fed sticky CPIs have also shown slower inflation progress recently, and that could imply the demand impulse behind inflation needs policy a bit more restrictive for a longer period of time. In September, the committee struck a hawkish tone. In December, a more dovish view with a stronger belief in the supply-side. We remain even keeled and look forward to the next one but we broadly agree with the Chair, whatever is going on, it's working.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2023 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.

The CIBC logo and "CIBC Capital Markets" are trademarks of CIBC, used under license.

CIBC Capital Markets – PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 – Bloomberg @ CIBC