

Economics

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June 15, 2022

Federal Reserve: Faster, higher, stronger

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Too many inflation reports that tested the Fed's patience have it adopting the Olympics slogan of "faster, higher, stronger" for its stance on rate hikes. Today's 75bp hike to a range of 1.50-1.75% was hinted at through media contacts on Monday, so the market was well prepared, and with that mega-step came an appropriately hawkish statement which included a reminder that the committee is "strongly committed" to returning inflation to its 2% objective. There was one dissenting voice against today's 75bp hike, favouring instead a somewhat smaller (but still unusually large) 50bp hike.

The updated forecast underscores the higher starting point for inflation, and the willingness to take a larger bite out of growth ahead to bring price pressures down. GDP is now expected to be up only 1.7% Q4/Q4 this year and next (previously 2.8% and 2.2%), and the unemployment rate is also now expected to have to move up (to 4.1% by 2024) in order to achieve a core PCE reading close to target by the end of the forecast horizon. In his press conference, Fed Chair Powell highlighted business investment and housing as to areas that were already looking softer, while still describing the labour market as "extremely tight".

Even with the downgrade to GDP growth today, the Fed's projections still appear a little strong relative to our own revised forecast (1.2% and 1.1% in 2022 and 2023 respectively) and relative to what we suspect is achievable with interest rates on the rise.

The median dot plot projections from FOMC members show rates rising to 3.4% this year and 3.8% in 2023, which would be well above the 2.5% longer-run neutral projection. While we see that as overkill and unlikely to materialize, another 75bp move at the next FOMC, and a peak of 3.25% for the fed funds ceiling attained this year, now seems likely before Powell's team sees enough signs of a slowing to stop at that level. While Powell stated in the press conference that 75bp moves should not be considered the norm, he also stated that a move of either 50 or 75bp at the next meeting would be most likely unless there was compelling evidence that inflation was starting to moderate.

Implications & actions

Re: Economic forecast — The Fed is more likely to see evidence of rising inflation and inflation expectations, rather than moderating trends, by the time of the next meeting, so we suspect that policymakers will opt for another 75bp hike at that time. With the Fed having normalized a 75bp move, we see the BoC also hiking by that amount in July. However, we also suspect that a more pronounced slowing in the economy, eventually resulting in a moderation of inflation, will see the fed funds ceiling peak at 3.25%, which would be 50bp lower than the median dot plot projections released with today's statement.

Re: Markets — Markets were braced for a big move today and a hawkish tilt to the dot plot projections, and as such reaction has been fairly limited so far. Bond yields were up slightly after the statement, but eased off after Powell's press conference remarks that suggested another 75bp hike was not guaranteed.

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