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A possible pause

FOMC Post-Meeting Comment May 2023

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Summary

- As expected, the FOMC delivered a hike of 25 bps, removed the *"The Committee anticipates that some additional policy firming may be appropriate"* language from the formal statement -laying the groundwork for a pause-, and Powell confirmed that the Committee does not expect to cut rates this year.
- However, Powell said that a decision about a pause was not made at this meeting, although he stressed that the change in language was meaningful.
- Therefore, we perhaps should characterize this as "a possible pause."
- We expect the FOMC to remain on hold for the remainder of the year.

Introduction

As expected, the FOMC raised the target range for the federal funds rate by 25 bps to 5.00-5.25%. The decision was unanimous. With *First Republic* out of the way, which was the main threat to a rate hike, as we discussed in our preview, the FOMC was able to reach the terminal rate from the projections made in March. As we expected, the FOMC removed the "some additional policy firming" language from the formal statement -laying the groundwork for a pause-, and Powell confirmed that the Committee does not expect to cut rates this year.

Statement

The change in the statement that was of most interest to the markets was of course related to the forward guidance on rates policy. In the March statement, signalling another hike, *the Committee anticipated that some additional policy firming may be appropriate.* Today, the FOMC replaced this by "*in determining the extent to which additional policy firming may be appropriate,*" which suggests a possible pause in the hiking cycle, without actually committing to a pause. The sentence "in order to attain a stance of monetary policy that is sufficiently restrictive" was dropped, as today's rate reached the terminal rate in the FOMC's projections. Also, "in determining the extent of future increases" was merged with the additional policy firming phrase. Regarding the economy, the statement essentially repeated that economic growth is modest, job gains robust, unemployment low, and inflation elevated. The FOMC repeated that the banking system is sound and resilient, but tighter credit conditions are likely to weigh on economic activity, hiring, and inflation. There was no update of the projections of FOMC participants.

Table 1: Median projections of FOMC participants (March 2023)

Variable	*2023*	*2024*	*2025*	*Longer run*
GDP growth	0.4 (0.5)	1.2 (1.6)	1.9 (1.8)	1.8 (1.8)
Unemployment	4.5 (4.6)	4.6 (4.6)	4.6 (4.5)	4.0 (4.0)
PCE inflation	3.3 (3.1)	2.5 (2.5)	2.1 (2.1)	2.0 (2.0)
Core PCE inflation	3.6 (3.5)	2.6 (2.5)	2.1 (2.1)	
Federal funds rate	5.1 (5.1)	4.3 (4.1)	3.1 (3.1)	2.5 (2.5)

Source: FOMC, March 22, 2023 (December 14, 2022)

Press conference

In his prepared statement, Powell said that any future policy action will depend on how events unfold and the FOMC will make that decision meeting-by-meeting. During the Q&A, he said that the decision on a pause was not made today, but he stressed that the change in language was meaningful. He said the FOMC did discuss pausing, but not for this meeting. Powell said that the Committee could afford to look at the data. In other words, the FOMC is hinting at a pause, laying the groundwork by altering the language, but not committing to a pause yet. Meanwhile, Powell repeated that the FOMC does not expect to cut rates: he said that their forecast is that inflation will fall only slowly, and in this world it would not be appropriate to cut rates. Powell said that the Fed staff still forecasts a mild recession, but that he believes it is still possible to avoid a recession. He believes that avoiding a recession is still more likely than having a recession. But he said that a mild recession was possible.

Conclusion

Powell still believes in a soft landing, but his own staff expects a mild recession starting later this year, with a recovery over the subsequent two years. We have been forecasting a US recession in the second half of 2023 since last year. In fact, we think a recession is inevitable if the Fed wants to get inflation back to its 2% target rate. What's more, the dependence of the FOMC on tightening credit conditions going forward has reduced the probability of a soft landing even further. However, since the FOMC is in Volcker-mode and core inflation and nominal wage growth remain persistent at elevated levels, we do not expect a pivot by the Fed (i.e. rate cuts) in 2023. At the same time, we expect no further rate hikes for the remainder of 2023. The FOMC is likely to wait and see what the lagged impact from the hiking cycle is, how credit tightening unfolds, while problems at banks may further discourage the Committee from hiking further this year.

Table 2: Rabobank forecasts of target range for federal funds rate in 2023

FOMC meeting	*Size of rate hike (bps)*	*Target range (%)*
Jan 31-Feb 1	25	4.50-4.75
March 21-22	25	4.75-5.00
May 2-3	25	5.00-5.25
June 13-14	0	5.00-5.25
July 25-26	0	5.00-5.25
Sept 19-20	0	5.00-5.25
Oct 31-Nov 1	0	5.00-5.25
Dec 12-13	0	5.00-5.25

Source: Rabobank

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