Fed Watch

Fed skips rate rise but hints it is set to hike in July…

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… and signals that 50bp worth of total additional hikes might come

- **The FOMC voted unanimously to keep the target range for the fed funds rate unchanged at 5.00-5.25%.** The decision to skip a rate rise at this meeting was widely expected, but Fed members had been cautious to label today's most likely decision as a "skip" rather than a "pause" so that it wasn't interpreted as the end of the hiking cycle. Although the wording of the statement was mostly unchanged, it reinforced the view that the door for an additional hike after today's meeting is wide open. The statement indicated that holding the fed funds rate steady would allow the FOMC to "assess additional information and its implications for monetary policy." As we expected, with progress in getting core inflation down still slow and the labor market still strong, the Fed was likely to give hawkish forward guidance in the updated SEP (see). **Chair Powell and the updated SEP suggest the Fed is most likely set to hike again in July, and that 50bp worth of total additional hikes might be on the way before the end of this year.**

- **A hawkish shift in the updated SEP signals that, with a more resilient economy and more stubborn inflation, nearly all members think that the Fed needs to do more.** With recent indicators suggesting that economic activity has continued to expand at a modest pace driven by consumer spending and a very tight labor market, the median projection for real GDP growth and core PCE inflation by year-end were revised up to 1.0% and 3.9% (from 0.4% and 3.6% in March). Accordingly, the unemployment rate forecast declined to 4.1% from the previous 4.5% projection. The economic outlook for 2024 and 2025 remained largely unchanged, with the economy still expected to grow at a below-trend pace by the end of next year (1.1%) before returning to its longer-run pace in 2025. A more resilient economy in the near term was reflected in a hawkish shift for the projected appropriate policy path. The median FOMC participant now projects that the fed funds rate will reach 5.6% at the end of this year, before declining to 4.6% and 3.4% by the end of 2024 and 2025, respectively (Table 1). This month's updated dot plot shows that most participants (⅔) project at least two additional 25bp rate hikes this year (Figure 1).

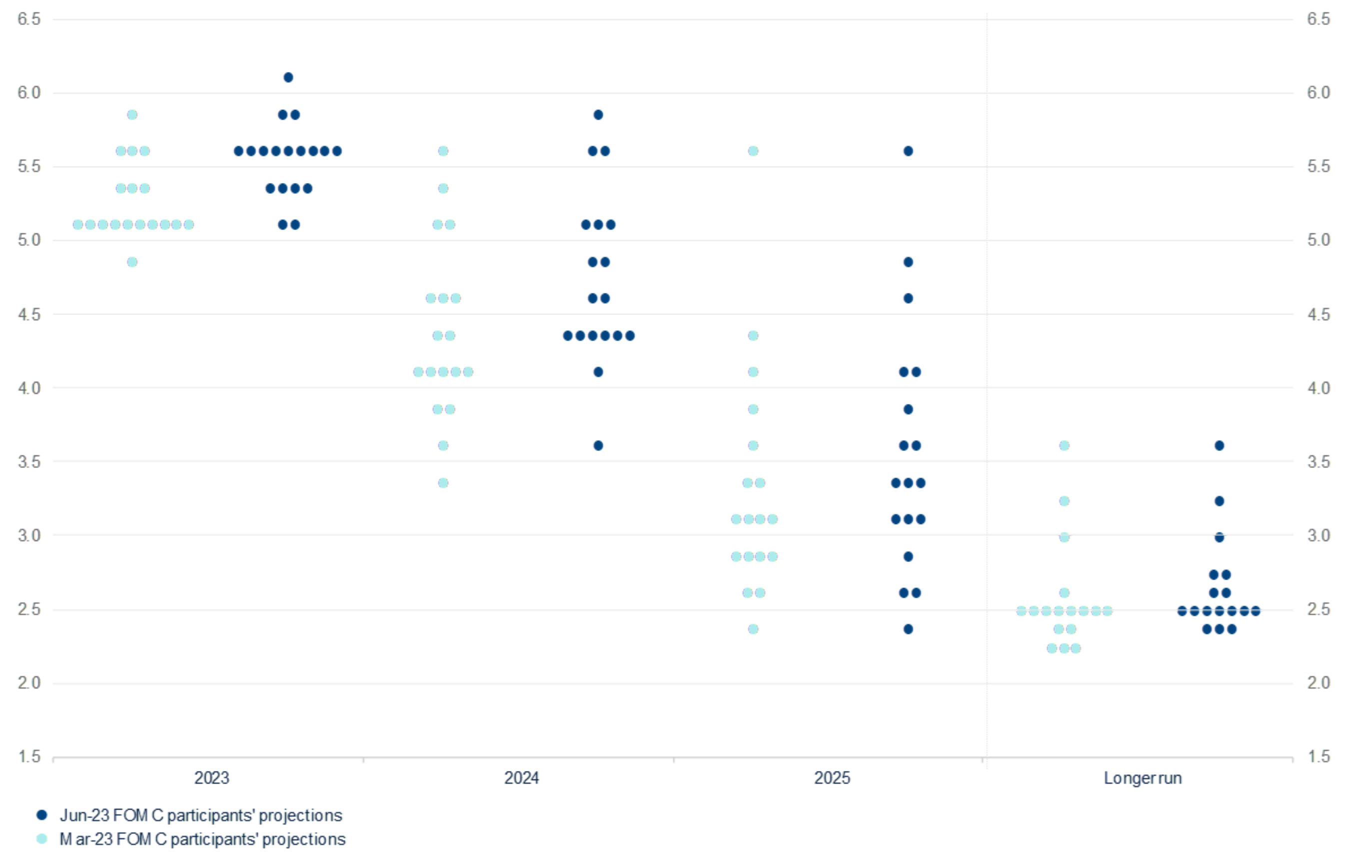
- **Powell said** in the press conference **that next month's meeting will be a "live" one**, reinforcing the dot-plot's message that nearly all participants (16 out of 18) view as likely that "some further rate increases will be appropriate this year" and **sending a strong signal that a 25bp hike in July is now very likely**. He added that the updated projections together all point to the same thing: that perhaps "more restraint will be necessary." Overall, Powell's comments signaled that today's decision to forgo a rate rise represents a skip rather than a longer pause. Powell added that the "risks of overdoing and underdoing it are closer to being in balance", signaling the Fed still remains more concerned with a sticky-inflation scenario. Thus, **we now think the odds of a 25 bps hike to a 5.25-5.50% target range in July have risen sharply**, but considering that "things are headed in the right direction", the Fed would likely skip in September, and by November, there will likely be more signs of progress and the Fed might see the softening in core inflation it wants before ending the hiking cycle (Powell signaled that -0.5 pp would be enough to feel more comfortable given that it continues to acknowledge that much lower inflation will take time). Thus, **for now we think that only one more hike is likely** and we continue to expect the beginning of a rate cut cycle next year.

A more resilient economy in the near term was reflected in a hawkish shift for the projected appropriate policy path: most participants (9 out of 12) project at least two additional 25bp rate hikes this year

Table 1. **FOMC PARTICIPANTS' SUMMARY OF ECONOMIC PROJECTIONS** (JUNE 2023, %)

Variable	Median				Central tendency				Range			
	2023	2024	2025	LR	2023	2024	2025	LR	2023	2024	2025	LR
Change in real GDP	1.0	1.1	1.8	1.8	0.7-1.2	0.9-1.5	1.6-2.0	1.7-2.0	0.5-2.0	0.5-2.2	1.5-2.2	1.6-2.5
Mar-23	0.4	1.2	1.9	1.8	0.0-0.8	1.0-1.5	1.7-2.1	1.7-2.0	-0.2-1.3	0.3-2.0	1.5-2.2	1.6-2.5
Unemployment rate	4.1	4.5	4.5	4.0	4.0-4.3	4.3-4.6	4.3-4.6	3.8-4.3	3.9-4.5	4.0-5.0	3.8-4.9	3.5-4.4
Mar-23	4.5	4.6	4.6	4.0	4.0-4.7	4.3-4.9	4.3-4.8	3.8-4.3	3.9-4.8	4.0-5.2	3.8-4.9	3.5-4.7
PCE inflation	3.2	2.5	2.1	2.0	3.0-3.5	2.3-2.8	2.0-2.4	2.0	2.9-4.1	2.1-3.5	2.0-3.0	2.0
Mar-23	3.3	2.5	2.1	2.0	3.0-3.8	2.2-2.8	2.0-2.2	2.0	2.8-4.1	2.0-3.5	2.0-3.0	2.0
Core PCE inflation	3.9	2.6	2.2		3.7-4.2	2.5-3.1	2.0-2.4		3.6-4.5	2.2-3.6	2.0-3.0	
Mar-23	3.6	2.6	2.1		3.5-3.9	2.3-2.8	2.0-2.2		3.5-4.1	2.1-3.1	2.0-3.0	
Federal funds rate	5.6	4.6	3.4	2.5	5.4-5.6	4.4-5.1	2.9-4.1	2.5-2.8	5.1-6.1	3.6-5.9	2.4-5.6	2.4-3.6
Mar-23	5.1	4.3	3.1	2.5	5.1-5.6	3.9-5.1	2.9-3.9	2.4-2.6	4.9-5.9	3.4-5.6	2.4-5.6	2.3-3.6

Figure 1. **FOMC PARTICIPANTS' PROJECTED APPROPRIATE FEDERAL FUNDS RATE** (%)



Source: BBVA Research based on data by the Federal Reserve and Haver Analytics.

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