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Daily Economic Update

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Fed slows its tightening cycle but maintains hawkish messaging

- 50 bp hike was widely expected, down from 75 bps at previous four meetings
- Dot plot points to at least 75 bps of further hikes, above market pricing
- We don't see the Fed holding its policy rate above 5% throughout 2023

The Fed has consistently leaned hawkish in the second half of 2022 and kept that up at its final meeting of the year. Yes, it delivered a widely expected 50 bp hike, down from 75 bp increases at each of its past four meetings. But it once again tried to guide market expectations for the terminal policy rate higher. The committee refrained from softening its forward guidance—"ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive"—and the vast majority of members now see fed funds rising above 5% next year (50 bps higher than September's median and above market pricing). The dot plot shows 100 bps of rate cuts in 2024 whereas the market sees cuts beginning in the second half of next year and more cumulative easing by the end of 2024.

Today's hawkish tone suggests some discomfort with recent easing in financial conditions (10-year Treasury yields are down ~75 bps from their cycle highs, equities have rebounded and the US dollar has retreated from record highs) not unlike what we saw six months ago. But will the Fed actually lift its policy rate above 5% and keep it there throughout 2023? We'll take the "under" amid growing evidence that inflation has peaked (both headline and core) and signs that the economy is losing momentum. Despite a notable downward revision to its 2023 median GDP growth forecast (0.5% year-over-year in Q4/23 vs. 1.2% previously) and a slightly higher unemployment rate profile (2023 and 2024 both at 4.6% vs. 4.4% previously) we continue to think the Fed's outlook is optimistic. Chair Powell pointed to higher inflation forecasts in justifying upward revisions to the dot plot, but if recent trends hold we think inflation will ease somewhat faster than the Fed is assuming.

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