RBC Economics

Daily Economic Update

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Another 75 basis point hike from the Fed, and more on the way

- Fed hikes by 75 bps to 3-3.25%, as expected
- Further rate increases to come—dot plot shows another 100-125 bps by year end
- Fed projecting soft landing but emphasizing resolve to get inflation back to target

The US Federal Reserve raised its policy rate by 75 bps at a third consecutive meeting today, lifting the fed funds target range to 3-3.25%—just into restrictive territory according to Chair Powell. The Fed's key message continued to be that rates will have to rise further with Powell saying the Fed will "keep at it" until the job is done. Most committee members think "keeping at it" will require a further 100-125 bps of (cumulative) tightening at the remaining two meetings this year (more than the 75 bps we have penciled in) and another hike or two in 2023 (we assumed the Fed will be done after December). While markets were already pricing in a more aggressive policy path given recent Fed communications, today's hawkish tone still pushed equities lower and short-term yields higher.

Indeed, today's messaging didn't deviate significantly from Chair Powell's hawkish Jackson Hole speech in which he emphasized further rate hikes to come and said restrictive monetary policy will be needed for some time. Powell has said higher rates will cause some pain for households and businesses but the committee's projections continue to show a fairly soft landing with the unemployment rate rising to just 4.4% by the end of next year from 3.7% in August (and a long-run rate of around 4%). Even with a more aggressive policy rate forecast, the Fed marked its inflation projections higher once again and now sees core PCE remaining slightly above 3% by the end of 2023. The committee has linked its policy decisions to "compelling evidence inflation is moving down" and was likely disheartened by a surprising increase in core CPI in August.

We're mindful that the Fed is leaning hawkish to prevent the sort of premature easing in financial conditions we saw earlier this summer, and might not actually deliver the rate hikes shown in today's dot plot. But risks around our forecast for fed funds to peak at 3.75-4% later this year are tilted firmly to the upside and a single CPI print between now and the Fed's early-November meeting might not be enough for the committee to dial back the pace of rate hikes as we were assuming. While the near-term profile might be more aggressive, we continue to think sluggish growth over the second half of this year and some improvement in the inflation backdrop will allow the Fed to pause its tightening cycle in 2023. We continue to expect a mild recession next year.

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