May 3, 2023

Fed hikes but opens the door to a pause

- Fed funds target range raised by 25 bps to 5.00-5.25%, matching March's dot plot median
- Policy statement opens the door to a pause in June, in line with our forecast
- Softer data and banking concerns give cause for the Fed to move to the sidelines

Today's 25 bp increase was widely expected by analysts and investors and may be the last of the cycle. The fed funds target range of 5.00-5.25% is now in line with March's dot plot median (i.e., the FOMC's terminal rate consensus from six weeks ago) and tweaks to the policy statement opened the door to a pause at the next meeting in June. Rather than anticipating "some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive," the Committee will now determine "the extent to which additional policy firming may be appropriate."

At his press conference, Chair Powell called that a "meaningful change" but also said "a decision on a pause was not made today." With 7 of 18 FOMC participants in March thinking rates would have to move even higher, we can't rule out one more hike at this stage. But in our view this new language suggests the Committee's base case is to pause in June—in line with our forecast, consensus, and market pricing—and the onus is on data to surprise to the upside for rates to rise further.

Other changes to the policy statement were limited, with the Committee continuing to point to modest economic growth, robust job gains, low unemployment, and elevated inflation. While Chair Powell said the labour market remains "very tight" he noted "some signs that supply and demand in the labor market are coming back into better balance" as well as evidence that wage growth is easing. He also pointed to signs of policy traction and said the economy is likely to face "further headwinds" from tighter credit conditions due to strains in the banking sector. Between growing cracks in the labour market, signs the economy is losing momentum, and uncertainty around the impact of banking turmoil, we think the Fed has plenty of cause to move to the sidelines after today's rate increase.

Josh Nye | Senior Economist, RBC Economics | Royal Bank of Canada | T. (416) 974-3979

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