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With a dovish 25 bp hike, the Fed's tightening cycle is nearing an end

- Today's 25 bp hike was largely anticipated, but only after market expectations whipsawed in recent weeks
- Fed says recent developments will tighten credit conditions and weigh on the economy
- Statement flags "some additional policy firming"; dot plot median points to one more hike

The Fed hiked its benchmark rate by 25 bps in a unanimous decision today but softened its tone on further increases, saying "some additional policy firming may be appropriate." Its previous language called for "ongoing increases." The dot plot was little changed with the median continuing to point to a terminal fed funds rate of 5.00-5.25% (i.e. one further hike) but 7 of 18 FOMC members still favouring additional tightening beyond that. Prior to recent turmoil, comments from Chair Powell and other Fed speakers suggested terminal rate views were shifting higher in the wake of firmer-than-expected data. But recent developments seem to have nixed that, lending today's decision a dovish tone.

As we noted in our preview, stress in the banking sector will tighten lending standards and do some of the Fed's work for it. Indeed, today's statement noted that while the banking system is "sound and resilient," recent developments "are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring, and inflation." The committee's GDP growth forecasts were revised down by 0.1 and 0.4 ppts for this year and next, respectively, and Chair Powell said "nearly all participants see the risks to GDP growth as weighted to the downside." Unemployment is expected to rise by a full percentage point by year end but not much further in 2024, continuing to make this a "soft landing" scenario. The Fed's already-high inflation forecasts (which look a bit less aggressive following strong prints early this year) were revised slightly higher, with headline and core PCE seen at 3.3% and 3.6%, respectively by year end.

Today's move was in line with consensus and market pricing but much less of a foregone conclusion than typical Fed decisions. Two weeks ago the market was leaning toward a 50 bp hike with Chair Powell having opened the door to a larger move if the totality of incoming data warranted it. One week ago there were doubts that the Fed would raise rates at all amid turmoil in the banking sector. The market finally coalesced around a 25 bp increase, though there were some odds and several calls for the Fed to take a pass. We expected a hike but wouldn't have argued with the Fed waiting six weeks until its next meeting to better assess the impact of recent events and any further risks to the banking sector. Today's dovish tone and guidance, at least, suggests policymakers are now more mindful of the risks of over-tightening. And if today's hike isn't the last, we're getting very close to terminal.

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