September 20, 2023

U.S. Fed skips September rate hike

- The U.S. Fed (as widely-expected) held the fed funds target range steady at 5.25% to 5.5% in September, marking the second time this year the committee opted not to hike interest rates this year after 'skipping' an increase in June.
- The decision was despite an economic growth backdrop that continues to surprise on the upside - the Fed referred to economic activity as expanding at a 'solid' pace compared to the 'moderate' growth referenced in July.
- GDP growth forecasts in the accompanying Statement of Economic Projections were revised higher (2.1% this year versus 1.0% assumed in June), and the projection for the unemployment rate was cut significantly to 3.8% expected in Q4 this year (from 4.1% previously) and 4.1% (was 4.5%) at end-of-2024. The unemployment rate is already at 3.8% as of August, implying little assumed deterioration in labour markets.
- But inflation pressures have continued to show signs of slowing, and are no longer pressuring the Fed to react quickly. Inflation projections were little-changed from June, suggesting the Fed thinks their upgraded economic growth forecasts are still soft enough for inflation pressures to ease back towards their 2% objective over time.
- 12 out of 19 meeting participants still expect to hike the fed funds target range by another 25 basis points this year. But the statement again repeated that policymakers will be assessing how much additional policy firming "may be" appropriate - reiterating that additional rate increases are not a foregone conclusion.
- The median fed funds rate expected by participants at the end of 2024 was revised up by 50 basis points from the last update in June (to 5.1%) implying a more cautious shift to rate cuts than previously expected. But the range of projections in future years is exceptionally wide (from 4.4% to 6.1% for end of 2024) suggesting the committee itself has little conviction on the appropriate level of interest rates beyond the next several months.

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- **Bottom line:** Chair Powell reiterated that monetary policy is already at 'restrictive' enough levels to push inflation pressures lower over time, and that has let policymakers shift to a more 'data-dependent' approach to future interest rate decisions. To-date, easing inflation pressures have come without significant increases in unemployment, but labour demand (job openings) has continued to slow, credit conditions have tightened, and the growth backdrop is showing more significant signs of slowing in the rest of the world as headwinds from higher interest rates build. We continue to expect that economic growth and labour markets will soften, but the Fed is also still clearly willing to hike interest rates further if inflation were to show signs of reaccelerating.