



June FOMC Meeting: Hawkish Pause +

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Whatever It Takes to Bring Inflation Back to 2%

- ▲ The Federal Reserve left its federal funds rate target unchanged at 5-5.25%.
- ▲ There was relatively little change to the Fed’s policy statement, with recent data showing overall growth at a “modest pace” but with “robust” job gains.
- ▲ The Summary of Economic Projects (SEP) shows the Fed believes the economy is more resilient than previously thought and inflation is expected to be more persistent.
- ▲ A majority of FOMC members believe the federal funds rate will need to be raised at least 50 basis points by the end of this year.
- ▲ Powell was hawkish at his press conference, stressing the risks to inflation were still tilted to the upside and that the Fed was prepared to do whatever it takes to bring inflation back to their 2% target.
- ▲ Bottom line: *The Fed’s upgraded forecast was slightly more hawkish than expected and may have been designed to remove any lingering expectations they would cut interest rates later this year.*

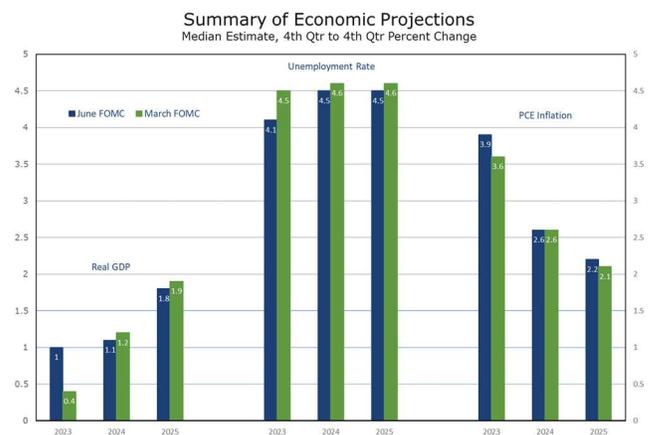
The Federal Reserve took a break from raising interest rates at their June FOMC meeting and left the federal funds rate target unchanged at between 5 and 5 ¼%. The decision was widely expected but does not likely signal an end to the Fed’s interest rate hikes.

There was very little change in the policy statement that accompanied the Fed’s decision. The Fed still sees the economy growing at a modest pace and notes that job growth remains robust. The Fed also noted that “tighter credit conditions for households and

businesses are likely to weigh on economic activity, hiring, and inflation. While that sentence is identical to the language in the May 3rd statement, it is also the primary justification for the Fed’s decision to hold rates steady. There is simply not enough conclusive evidence as to how much impact tighter credit standards are having. We will get key data on the bank stress tests and bank earnings ahead of the July 25-26 meeting.

The economy is expected to be more resilient, and inflation is expected to be more persistent.

While the policy statement was little changed, the Fed’s forecast shows the economy is expected to be more resilient than previously thought, particularly in the near term. Inflation, however, is expected to be more persistent. The median forecast for 2023 real GDP growth in the Summary of Economic Projections was raised by 0.4 percentage points to 1.0%, on a fourth quarter to fourth quarter basis, while the forecast for the unemployment rate was reduced by 0.4 percentage points to 4.1%. The median forecast for core inflation was raised by 0.3 percentage points to 3.9% year-to-year in the fourth quarter.



Source: Federal Reserve Board



Decelerating to a 3.9% rise by yearend may prove difficult. The core PCE deflator currently sits at 4.7% and the index has risen an average of 0.38% a month over the past six months. To decelerate to a 3.9% rise by year end, the core PCE deflator would need to slow to an average of just 0.23% per month. While such a sudden sustained slowdown is not unprecedented it is exceedingly rare. Yearend core inflation is expected to slow to 2.6% in 2024 and 2.2% in 2025.

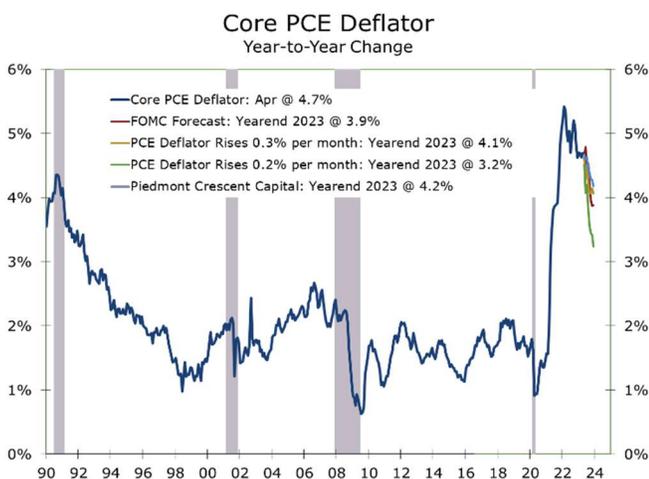
The Fed’s economic forecasts for 2024 and 2025 were less impacted. GDP growth for both years was reduced by 0.1 percentage point, to 1.1% and 1.8%, respectively, while the yearend unemployment rate was reduced by 0.1 percentage point to 4.5% in both years. A 4.5% unemployment rate looks credible and is at the upper bound of the range considered to be full employment, providing cover to the Fed against critics arguing the Fed is pushing the economy into recession.

With core inflation expected to remain higher for longer, the median forecast for the yearend 2023 federal funds rate target was raised by 50 basis points to 5.6%. The Fed is expected to cut the federal funds rate by a full percentage point in 2024, bringing the funds rate target back to 4.6% and to cut rates by slightly more in 2025, ending the year at 3.4%. The long run federal funds rate was unchanged at 2.5%. The Fed can cut rates, even though inflation remains above their target, because real interest rates will be rising.

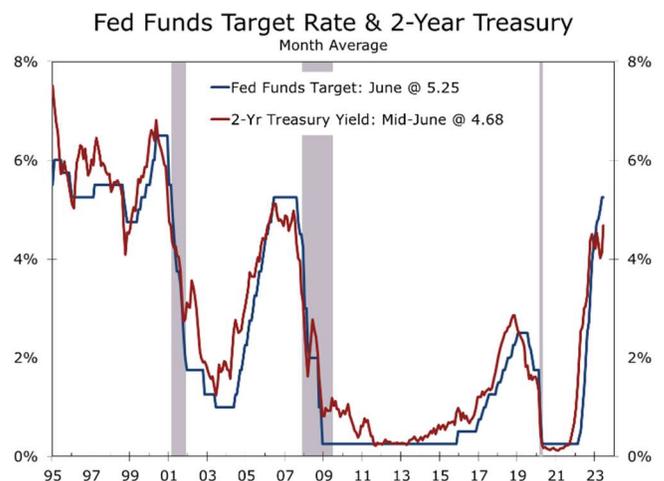
The Fed’s forecast was a bit more hawkish than expected. Twelve of the 18 FOMC members are projecting at least 2 more rate hikes, with 4 projecting even more than that. The trending vernacular prior to the June meeting was the Fed would “skip” hiking rates at this meeting and resume hiking rates at the July meeting. Powell addressed this at the press conference, emphasizing July would be a “live meeting”, meaning any decision will be dependent upon the data released before the July 25-26 meeting.

Getting the message right is critical. Housing and the financial markets have already firmed, sensing the Fed is nearly finished hiking rates. The increase in the core inflation forecast and Powell’s blunt assurance to do “whatever it takes” to bring inflation back down to their 2% target should help temper that enthusiasm.

We continue to believe the Fed will hike rates only one more time but are inclined to take the Fed at their word. Core inflation is proving remarkably persistent and will likely top the Fed’s forecast this year. Still, we see no more than two more quarter-point hikes this year. Tightening credit conditions will do some of the Fed’s work for them and the Fed can still meet its objective by holding rates higher for longer.



Source: BEA, Federal Reserve Board & Piedmont Crescent Capital



Source: Federal Reserve Board

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