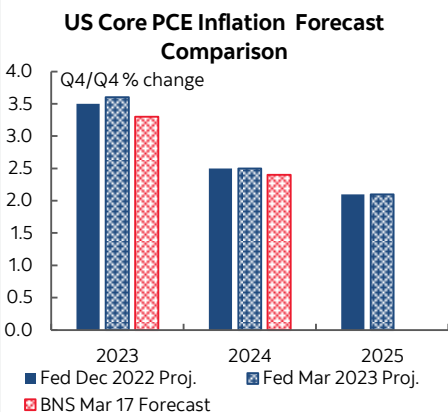


Contributors

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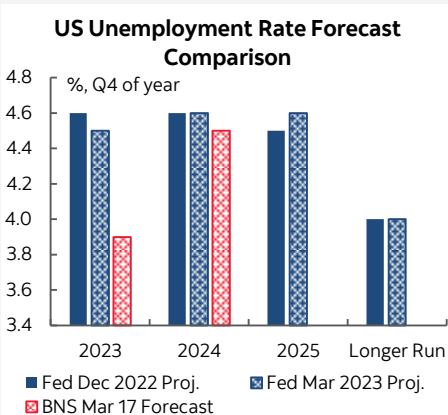
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Chart 2



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 22, 2022).

Chart 3



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar 22, 2022).

Powell Walked Down the Middle

- The FOMC hiked by 25bps and guided one more possible hike to come.
- They left the terminal rate unchanged, but reduced next year’s projected cuts.
- QT plans were left unchanged
- Tightened conditions equate to roughly a 25bps hike...
- ...but Powell emphasized high bidirectional uncertainty toward this estimate

The FOMC unanimously hiked the fed funds target range by 25bps to a new upper bound of 5% as expected by Scotia Economics. There were trade offs in the rest of the communications and markets reacted by pouncing on the uncertainty in favour of adding to rate cut bets over the duration of this year despite Powell’s expected rejection of such a scenario.

Please see the statement [here](#) and the accompanying Summary of Economic Projections including the ‘dot plot’ [here](#). Also see the statement comparison of changes that were made at the back of this note.

The US 2-year Treasury yield fell in the aftermath of all of the communications, the dollar depreciated a touch and the S&P500 fell. Some of this reaction was no doubt just as much driven by what the FOMC did not do as what it did do and positioning swings around alternative outcomes.

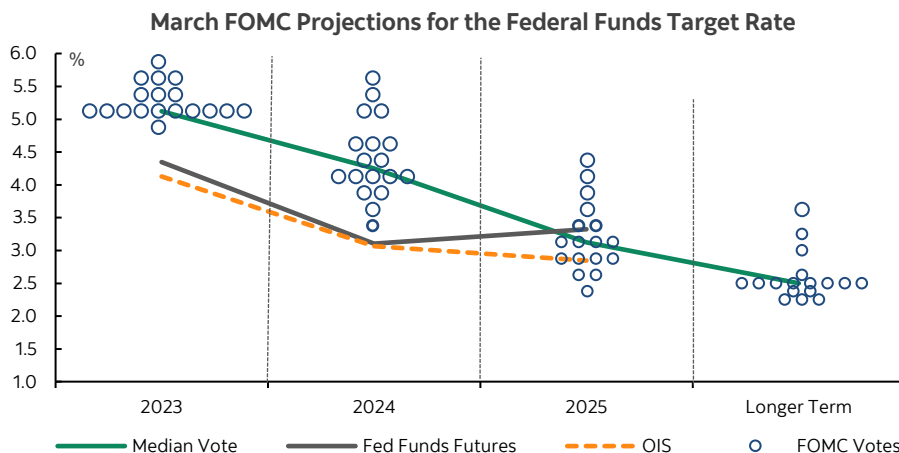
My overall impression is that what the FOMC did as described below is defensible. Too abruptly swinging in either direction could have rocked fragile confidence. That said, it's all just a bunch of placeholders for now and perhaps there will be greater clarity into the next 1–2 meetings that will inform their stance and future forecasts at the June meeting.

TERMINAL RATE GUIDANCE TRADE-OFFS

Chart 1 below shows the updated ‘dot plot’ of forward rate guidance by individual FOMC committee members. I'm glad they rejected some calls to suspend the SEP/dots which would have sent an awful signal, but still, the Committee’s guidance on the rate path from here is to be treated as very loose in my opinion.

Terminal rate guidance was left unchanged at where it stood in December for this year but with a subsequent catch. The FOMC still anticipates a policy rate peak of 5¼% this year. That implies a possible additional 25bps hike but the statement now says this “may be appropriate” which is less committal than prior guidance.

Chart 1



Note: OIS & Fed Fund Futures as of March 22, 2023.
 Sources: Scotiabank Economics, US Federal Reserve.

Also in the dot plot is that they reduced the amount of guessed easing in 2024 by 25bps. Now the terminal rate ends 2024 at 4.3% instead of 4.1%. Remember that these are mid-points of the fed funds target range. The rest of the 2025 and longer run rate path were left unchanged

Overall their rate guidance is kind of a wash. They didn't raise the terminal rate and "may" hike again, but they cancelled out one cut they previously had next year. Games with dots, I say.

ON TIGHTENED FINANCIAL CONDITIONS

A key issue is the effort around guesstimating how much damage has been done by tightened financial conditions to the economy in disinflationary fashion that requires fewer possible rate hikes or possible cuts. Powell was quite candid when he addressed this issue.

His press conference emphasized that it is too soon to assess the implications of recent turmoil. That is why they softened ongoing increases.

He is defining the tightened conditions as equivalent to 25bps while saying "though it is not possible" to be precise. This estimate is backed by the difference between leaving the terminal rate unchanged at 5¼% as they did versus had they stuck to the likely plan before the recent turmoil and raised the terminal rate by probably at least another 25bps. Some had argued that turmoil wiped out the need for any further hikes if not raising the case for a cut and the FOMC has clearly rejected such possibilities at least for now.

Powell candidly stated that "it's possible that the effects of recent turmoil could turn out to be quite modest or drive material further tightening of financial conditions. We simply don't know."

In case that point was missed, Powell reiterated it when probed further about why the FOMC doesn't see more disinflation coming from a credit crunch. He said "It's really just a question of not knowing at this point. There is a large body of literature on the direction of effects. This time we don't know the magnitude which is rule-of-thumb guesswork. That argues for being alert when thinking about future rate hikes."

Powell also resisted—and not unexpectedly so—a darker tone at this meeting by stating that "The banking system is sound and resilient. We took powerful actions with the Treasury and FDIC. Deposit flows in the banking system have stabilized in the past week." On SVB's woes he went on to note that " These are not weaknesses that are indicative of the overall system."

QT PLANS

There were no QT changes, as expected.

FORECASTS

There isn't a whole lot of forecast detail upon which to hang a major change in the FOMC's policy stance at this point. Here too there is a tremendous amount of guesswork that is involved.

As shown in chart 2, they raised the core PCE projection by one-tenth in 2023 to 3.6% and by one-tenth to 2.6% next year and then left 2025 unchanged at 2.1%.

The Committee's forecasts for the unemployment rate were very little changed. They only added one-tenth to 2025, reduced it by one-tenth this year and left next year unchanged. See chart 3.

GDP forecasts were revised the most, but not in earth shattering fashion. The Committee revised down the 2023 growth projection by 0.1% to 0.4% and now forecasts GDP to grow by 1.2% in 2024 from 1.6% previously and then 1.9% in 2025 from 1.8%. See chart 4.

HIGH UNCERTAINTY

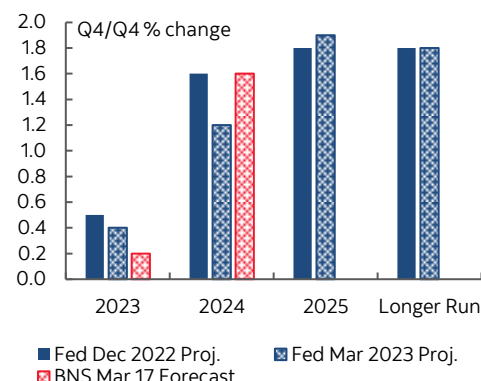
Having noted the changes, Powell emphasized the high degree of uncertainty around the forecasts but the statement continues to emphasize their main focus:

"The extent of these effects is uncertain. The Committee remains highly attentive to inflation risks."

This says they are more worried about inflation risk than the statement's prior sentence's description of tighter credit conditions.

Chart 4

US Real GDP Forecast Comparison



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Mar. 22, 2022).

Nevertheless, when asked about progress on inflation, Powell made it clear it hasn't been enough to date:

“Goods inflation has been coming down albeit slower than we would like. Housing services is a matter of time passing as lower leases work through. What we didn't have in February and we still don't have now is progress in services ex-housing inflation which is 56% of the index.” [ed. in reference to core PCE]

Powell also sounded as if he was unimpressed by progress on inflation and noted that "Inflation pressures continue to run high" while "the process of getting inflation back down to 2% has a long way to go" while nevertheless observing that inflation expectations remain well anchored.

Powell noted during the press conference that “nearly all' on the FOMC see the risks to GDP growth as weighted to the downside of their projections.

WHAT THEY DIDN'T DO

What the FOMC did not do likely factored as much into market reactions as what they did do. Here's a partial accounting of such.

- One shop thought they'd cut. Nope.
- A small number of shops thought they would hold. Nope.
- Some thought they would hike one last time and sent a definitive signal they were done. Nope.
- They could have added to the terminal rate. Nope.
- They could have added more easing in future. Nope, in fact they went the other way by reducing the amount of cumulative cuts by 25bps.
- They could have adjusted QT. Nope. That would've made no sense imo.

PAUSE REJECTED BOTH A PAUSE AND CUTS WHILE LEAVING THE DOOR OPEN TO GREATER HIKES

Powell was asked during the press conference about how seriously a pause had been considered at this meeting. He said:

“ We thought about this in the lead up to the meeting. A very strong consensus supported our decision. The inter-meeting data on inflation and employment was strong. It previously looked like we may have to hike by more.”

Powell was asked whether markets are getting it wrong in pricing one more rate hike in May and then cuts at every subsequent meeting.

He answered by stating that “Participants don't see rate cuts this year in their most likely case presented in the SEP.” Of course, you could make a strong case for how he wouldn't say anything to the contrary since it would likely cause a greater pile-on effect into pricing rate cuts.

In the other direction, Powell was asked whether he would be open to raising rates by more if inflation remains high and here too he gave the expected answer: “We will do what we need to do. We will eventually get to tight enough policy to get down to 2% inflation.”

March 22, 2023

RELEASE DATE: March 22, 2023

Recent indicators point to modest growth in spending and production. Job gains have picked up in recent months and are running at a robust pace; the unemployment rate has remained low. ***Inflation remains elevated.***

The U.S. 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 extent of these effects is uncertain.

The Committee remains highly attentive to inflation risks.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 4–3/4 to 5 percent. ***The Committee will closely monitor incoming information and assess the implications for monetary policy. The Committee anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time.*** In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Lisa D. Cook; Austan D. Goolsbee; Patrick Harker; Philip N. Jefferson; Neel Kashkari; Lorie K. Logan; and Christopher J. Waller.

RELEASE DATE: February 1, 2023

Recent indicators point to modest growth in spending and production. Job gains have been robust in recent months, and the unemployment rate has remained low. ***Inflation has eased somewhat but remains elevated.***

Russia's war against Ukraine is causing tremendous human and economic hardship and is contributing to elevated global uncertainty. The Committee is highly attentive to inflation risks.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 4–1/2 to 4–3/4 percent. ***The Committee anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time.*** In determining the extent of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in its previously announced plans. The Committee is strongly committed to returning inflation to its 2 percent objective.

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