RBC Global Asset Management

# Thoughts on the June 15th FOMC Meeting

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- We expect the US Federal Open Market Committee (FOMC) to deliver a 75 basis point (bp) hike and to tee up more hikes to come over the remainder of this year and into the next year, including a possibility of another 75bp move in July.
- While Fed chair Jerome Powell indicated a 50bp outcome as the most likely only a few weeks ago, worse-than-expected inflation data resulted in a major hawkish shift in markets' expectations; the market-implied path for Fed funds moved up over 75bp in just a week, with the June 2023 rate above 4%. The Fed cannot afford to be seen as "behind the curve" when its inflation fighting credibility is under question, thus a 75bp move quickly became "base-case" assumption. We now expect the Fed to indicate willingness to move firmly beyond the "neutral" rate level in order to fight inflation and contain any further increase in forward looking inflation expectations.
- As we look ahead, aggressive tightening of financial conditions is likely to continue. In the very near term, we see a possible scenario where resolute messaging from the Fed could bring about a short term risk rebound, as the market regains confidence in the Fed's ability to address inflationary risks. Nonetheless, aggressive rate hikes coupled with balance sheet reduction diminishes chances of a soft landing in the quarters ahead, casting a shadow over the remainder of the year.
- While the US economy has been in good shape up until recently (a strong labor market and pretty healthy consumers and corporations), recession risk has clearly picked up as we look towards 2023. We already see evidence of softening business conditions and multiple companies are highlighting emerging weakness in lower-income consumer cohorts. Whether the Fed's actions lead to a marked slowdown or an outright contraction will become clear over the quarters to come. A lot will depend on whether inflation responds quickly enough.

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