ECONOMIC UPDATE

REGIONS

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June FOMC Meeting: Saying They Will If They Have To, But Hoping They Won't Have To?

- The FOMC made no change to the Fed funds rate target range, leaving the mid-point of the target range at 5.125 percent
- The updated dot plot implies a terminal Fed funds rate target range mid-point of 5.625 percent, up 50 basis points from the March edition

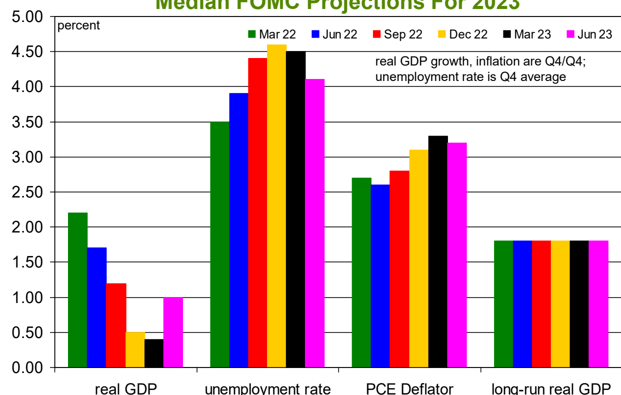
It's hard to imagine an instance in which a unanimous decision has come amid a division as sharp as that exhibited by the FOMC at their June meeting. While leaving the Fed funds rate target rate unchanged, as was widely expected, in a unanimous vote, which was not expected, the updated "dot plot" shows assessments of the appropriate path of the Fed funds rate amongst Committee to vary significantly. The updated dot plot implies a year-end 2023 Fed funds rate target range mid-point of 5.625 percent, fifty basis points higher than in the March edition, with year-end 2024 and 2025 mid-points also above those implied in the March edition. Updated economic projections indicate Committee members expect core inflation to be higher in Q4 2023 than had been projected in March, which helps account for the higher year-end funds rate than implied in the March projections. The outlier here is the pause in the series of funds rate hikes. After all, if you expect inflation to be higher and you expect to have to push the funds rate up by an additional fifty basis points, why wait to implement that, either fully or partially? Either you believe that changes in monetary policy impact the economy with long and variable lags and that pausing this month allows more time to assess the cumulative effects of the 500 basis points worth of funds rate hikes already implemented, or you believe (or hope) that talking tough, in the language of the dot plot, will lead to meaningful tightening in financial conditions that will in turn act as a brake on the pace of economic growth and inflation without necessarily believing that further rate hikes will ultimately be required. For that matter, both could be true, but we suspect the latter explanation carries more weight with many FOMC members.

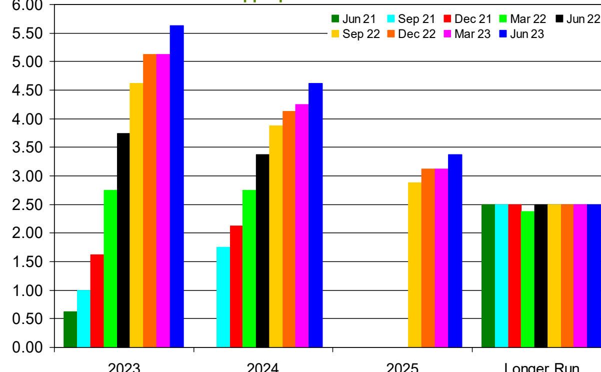
The description of economic conditions in the post-meeting policy statement is identical to that in the May statement – a modest pace of economic growth, robust job growth, low unemployment, and elevated inflation. Also unchanged is the passage noting that the banking system is "sound and resilient" but that tighter credit conditions will likely weigh on economic growth, hiring, and inflation to an uncertain degree.

The median forecast amongst FOMC members shows real GDP growth of 1.0 percent on a Q4/Q4 basis for 2023, up from 0.4 percent in the March projection, with slightly slower growth in both 2024 and 2025. The median projection shows an average Q4 2023 unemployment rate of 4.1 percent, down from 4.5 percent in the March projections, but what stands out is that the median projection shows an average Q4 2024 rate of 4.5 percent, a meaningfully larger increase from 2023 to 2024 than shown in the March projections. The median projection shows core PCE inflation averaging 3.9 percent in Q4 2023, up from 3.6 percent in the March projections, yet the Q4 2024 average rate remained at 2.6 percent.

The updated dot plot shows a terminal funds rate target range mid-point of 5.625 percent, up from 5.125 percent in the March edition, with the year-end 2024 mid-point at 4.625 percent, up from 4.25 percent in the March edition. What is striking is that only two members see no further rate hikes as being appropriate this year while one member sees an additional one hundred basis points of hikes as being appropriate and two others see an additional seventy-five basis points of hikes as warranted. The median dot implies one hundred basis points of rate cuts in 2024, about half a cut more than implied in the March edition.

In his post-meeting press conference, Chair Powell referred to today's decision as a "skip" but quickly corrected himself – "the skip, I shouldn't call it a skip" and noted that July is a "live" meeting, yet also reiterated that the FOMC is data dependent. With the June data to show another substantial drop-off in the pace of headline inflation, that sets up core inflation as the key metric the Committee is watching, and Chair Powell noted that the conditions that would bring about further deceleration in core inflation are in place, but the process is moving slowly, in contrast to the "decisive" progress members are looking for. Chair Powell noted that there were three elements in decisions on the path of the funds rate – how high it should go, how fast it should get there, and how long it should stay there. With most FOMC members seeing the funds rate close to, if not at, the appropriate terminal level, holding pat this month can be seen as appropriate, allowing time for more data to gather. At the same time, the FOMC is mindful of the risk that further rate hikes could exacerbate tightening in credit conditions, and the rate path implied by the updated dot plot would surely up that risk. So, the question remains whether the reality will live up to the rhetoric.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com