RBC Economics
Daily Economic Update

July 27, 2022

Fed delivers another 75 bps rate hike

- The Fed delivered a second consecutive 75 basis points rate hike
- Risks from high inflation continue to offset growth concerns
- More interest rate hikes, and softer labour markets, expected in coming months

The 75 basis point interest rate hike (to a 2.25% to 2.5% range) was widely expected, but marked a second-consecutive outsized increase. The 75 bp hike at the last meeting in June was the largest since 1994.

More rate hikes will follow. Chair Powell reiterated in his press conference the need for interest rates to get to at least a 'moderately restrictive level' by the end of this year - consistent with the 3.25% to 3.5% range FOMC members predicted at the last update in June (and our own assumptions.)

The Fed acknowledged that the economic growth backdrop has 'softened', but inflation concerns are taking precedence over growth worries. Some of the drivers of global price pressures have eased with shipping costs and key commodity prices declining in recent months. But domestic demand is running too hot for supply to keep up, and we expect that will keep a floor under near-term inflation rates. The unemployment rate is close to 50-year lows. Surging wages and elevated consumer demand are adding to longer-lived domestic price pressures and threatening to push longer-run inflation expectations higher. Chair Powell reiterated that some softening in labour markets is necessary to bring underlying inflation pressures back to their target rate.

With interest rates rising and the global economic growth backdrop slowing, we think it's hard to avoid seeing the economy contract and look for unemployment to drift higher and GDP to decline moderately over the first half of 2023. We expect policymakers could be in a position to pivot to cutting interest rates moderately in the second half of next year, but that is still contingent on inflation pressures slowing.

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