RBC Economics

Daily Economic Update

May 4, 2022

Fed hikes by 50 bps with more to come

- Fed funds target range lifted by 50 bps to 0.75-1.00%
- Additional 50 bp hikes on the table at upcoming meetings
- QT will begin shrinking the Fed's $9T balance sheet in June

Having kicked off its tightening cycle with a 25 bp increase in March, the Fed opted to accelerate the withdrawal of stimulus today with a larger, 50 bp move. It also said it will begin shrinking its balance sheet in June. The outsized rate increase, the first of its magnitude since 2000, and QT announcement were both widely expected. Even after today's hike, monetary policy remains quite stimulative with fed funds at least 125 bps below most committee members' estimates of its longer-run neutral level. There is a strong case to get to a more neutral stance in short order. Inflation accelerated to a 40-year high in March—with the Fed noting broadening price pressure—and the unemployment rate is close to pre-pandemic lows with wage growth trending higher. We think today's policy statement was right to downplay a soft Q1 GDP print—the first quarterly decline since Q2/20—with details pointing to an economy in which firm domestic demand is bumping up against capacity limits.

Chair Powell acknowledged the Fed needs to "expeditiously" move its policy rate up to a "broad range of plausible levels of neutral" (i.e. 2-3%). Markets are pricing in a series of 50 bp rate increases at upcoming meetings and Chair Powell seemed to validate that view, noting there is broad consensus on the committee that additional 50 bp increases should be on the table at the next couple of meetings. We expect a follow-up 50 bp hike in June and Powell's comments clearly suggest risk that our terminal fed funds forecast of 2.50-2.75% comes sooner than we have assumed. At the same time, Powell said the committee is not "actively considering" rate hikes of 75 bp or more at a single meeting—a comment that was likely a key factor in UST yields falling (particularly at the front end) during his press conference.

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