Fed minutes indicate a bias to hike, but we don't think it will carry through

The Federal Reserve cites inflation concerns as a reason to keep further rate hikes on the table, but splits are starting to form. We expect a September pause that will end up lasting well into the first quarter of 2024 when rate cuts will come onto the agenda

Jerome Powell, Chair of the Federal Reserve

Further hikes possible, but there are splits in the FOMC

The Federal Open Market Committee minutes to the July policy meeting, in which the Fed raised the policy rate range 25bp to 5.25-5.5%, show officials continue to have a bias to hike further, much as they outlined in their forecast update in June when they pencilled in the July hike plus one more before year-end. The key passage reads, "with inflation still well above the Committee's longer-run goal and the labor market remaining tight, most participants continued to see significant upside risks to inflation, which could require further tightening of monetary policy".

There is no specific guidance surrounding the September FOMC meeting, saying it will be down to the incoming information. Nonetheless, while the voting members of the FOMC all opted for a 25bp hike at the July FOMC meeting, there were two non-voting members who "indicated that they favored leaving the target range for the federal funds rate unchanged" if they had been on the roster to vote. Moreover, "a number of participants judged that... it was important that the

Committee's decisions balance the risk of an inadvertent overtightening of policy against the cost of an insufficient tightening".

As with some banks recently, Federal Reserve staff have also removed a "mild recession" as their base case (they are separate to the actual individual FOMC members' forecasts). Their base case now is that "real GDP growth in 2024 and 2025 would run below their estimate of potential output growth, leading to a small increase in the unemployment rate relative to its current level". This is broadly in line with the general view of FOMC members.

We see a long pause before 2024 rate cuts

Since this interest rate decision we have had the second 0.2% month-on-month core CPI print, encouraging news on moderating labour costs (the ECI index), more modest job creation, yet ongoing strength in activity data. The commentary from officials, including the hawks, such as Neel Kashkari, suggest a willingness to pause again in September, but to leave the door ajar for a further hike at either November of December FOMC meetings.

We think the Fed will indeed leave interest rates unchanged in September, but we don't think it will carry through with that final forecast hike. The combination of higher borrowing costs and less credit availability plus pandemic-era savings being run down and student loan repayments restarting should mean that households feel more of a financial squeeze in the fourth quarter and beyond and we expect to see consumer spending activity moderate. The concern is that it could go too far (as highlighted by some officials in these minutes) and heighten the chances of recession. Given this risk and the positive developments on inflation and labour costs we think the Fed will be on hold for a number of months. Our base case continues to be interest rate cuts from March 2024 onwards as monetary policy is relaxed to a more neutral footing.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the

Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit http://www.ing.com.