Preview: FOMC rate decision and SEPs due Wednesday 14th December at 19:00GMT/14:00EST; Press conference at 19:30GMT/14:30EST

SUMMARY: The FOMC is widely expected to hike rates by 50bps, as predicted by all 84 analysts surveyed by Reuters. Money market pricing is also leaning heavily towards a 50bp move with just a c. 3% implied probability of another 75bp increase in wake of the cool November CPI report, while recent Fed commentary (and minutes) has seen many officials express a desire to slow down the pace of rate hikes now we are approaching a "sufficiently restrictive level". With the upcoming meeting being accompanied by a fresh Summary of Economic Projections (SEPs) or "Dot Plots", it will be used to gauge what level sufficiently restrictive is, i.e. what is the expected terminal rate among the FOMC. Powell & Co have suggested it is likely to be somewhat higher than what was pencilled in at the September SEPs (4.6% in 2023) and money markets are pricing in a rate of 4.86%, implying an FFR of 4.75-5.00%.

RATES: All analysts surveyed by Reuters expect the FOMC to slow the pace of rate hikes to a 50bp increment in December, taking the target for the FFR to 4.25-4.50%. There is also plenty of attention on the FFR peak forecast from the Fed's dot plots, which is currently expected between 4.75-5.00% early next year, in line with money market pricing, however, the Reuters survey found that one-third of economists expect rates to go higher. It is likely that Powell will use his familiar line in the press conference to imply the forecasts are not concrete and can be subject to change, depending on the data. Analysts at Barclays are expecting the dot plot to show an upward revision in 2023 to 5.1% from 4.6% previously, while also suggesting it could revise the 2024 dot higher to emphasise its higher for longer message. Barclays writes "This would come as a hawkish surprise to investors, in our view, as recent Fedspeak has pointed to only a modest increase in the terminal rate and market participants have likely put a lot of weight on that". Looking ahead, the argument for another 50bp hike in February has diminished somewhat now after the cooler-than-expected November CPI. Analysts at Capital Economics write in wake of the data that it "provides strong support to our long-held view that mounting disinflation will soon persuade the Fed to move to the side line after one 25bp hike in early February."

INFLATION/EXPECTATIONS: CPI has started to show signs of easing with the latest November & October CPI reports cooling from the prior months and also printing beneath analyst expectations. The softening inflation prints will be welcomed by the Fed, but after the October report they were reluctant to declare victory yet and they want to see inflation well on its way to the 2% goal, and we will see what Powell has to say on the November data in the press conference. The latest inflation expectations from the UoM consumer sentiment survey were encouraging, as the short-term 1yr projection saw a notable move lower to 4.6%, while 5yr expectations were left unchanged at 3%, a welcome sign for the Fed with the 1yr now at the lowest level since September 2021 and implying that hot inflation is not becoming embedded in longer-term inflation expectations. Moreover, the latest NY Fed consumer inflation expectations were also encouraging, falling to 5.2% from 5.9%, while the 3yr expectation cooled to 3% from 3.1% with the 5yr easing to 2.3% from 2.4%. Nonetheless, more progress will want to be seen as the Fed has made it clear the risks of doing too little are greater than doing too much. TD Securities provides a list of possible economic projections that the Fed could signal, and for PCE inflation they see it left unchanged in 2022 at 5.4%, slightly higher in 2023 to 2.9% from 2.8%, but unchanged for 2024 and 2025 at 2.3% and 2.0% respectively. The desk highlights Core PCE could be revised up for 2022 to 4.6% from 4.5% and 2023 to 3.2% from 3.1%, but left unchanged for 2024 at 2.3% and revised lower for 2025 to 2.0% from 2.1%.

LABOUR MARKET/WAGES: The US labour market has been very resilient to the tightening of Fed policy and has not weakened as much as the Fed would have liked. The November jobs report was hotter than expected with payrolls growth of 260k and an unemployment rate of 3.7%, more or less in line with the Fed's 2022 projection of 3.8%, and they had pencilled in unemployment rising to 4.4% in 2023, something the Fed believes will result in a soft-landing. However, with the Fed fighting the demand side of the equation, a strong labour market hampers the fight against inflation. The most recent wages data was also hot, rising 0.6% M/M and 5.1% Y/Y, although many on the FOMC have stressed they do not believe there is a wage-price spiral. Analysts at TD Securities expect the unemployment rate in the SEP forecasts to be revised slightly lower in 2022 to 3.7% from 3.8%, but higher in both 2023 and 2024 to 4.6% from 4.4%, and 2025 to 4.4% from 4.3%.

FINANCIAL CONDITIONS: Softer inflation reports have eased financial conditions and analysts at Goldman Sachs highlight their financial conditions index has eased by c. 100bp from its peak (even before Nov CPI) and they expect the Fed to try to push back against the excessive easing in financial conditions, although they acknowledge this is not an easy task given expectations the tightening phase is close to being completed. GS highlights possibilities on how they could do this, including: "showing higher 2023 rates in the dot plot, Chair Powell suggesting that there could be more than one 50bp hike in his post-FOMC conference (we expect a 50bp increase at the meeting), or a material upward revision of the long run rate".

RECESSION: With the ongoing tightening, the chances of a recession are becoming more likely. The Reuters poll found 60% of those surveyed predicted a contraction for two consecutive quarters at some point in 2023, although a large majority said any recession would be short and shallow, while a few said it would be long and shallow and a minority said there will be no recession. The poll also saw that over 75% said the risk to their GDP forecasts were skewed to the downside. In their SEP forecasts, analysts at TD Securities see an upward revision to 2022 GDP to 0.4% from 0.2%, but a downward revision to 2023 to 1.0% from 1.2% with 2024 and 2025 left unchanged at 1.7% and 1.8% respectively.