Preview: FOMC rate decision due Wednesday 26th July 2023 at 19:00 BST / 14:00 EDT

Summary: The Fed is widely expected to hike rates 25bps in July, taking the target for the Federal Funds Rate to 5.25-5.50%. Markets, and the majority of economists, expect this to be the peak of the hiking cycle, despite Fed guidance for two more rate rises this year (including July). Therefore, attention will lie heavily on any guidance from Powell in his press conference, but he is likely to reiterate a data-dependent approach and not commit to any future decisions, noting they will be taking each meeting as it comes. Any language around the June dot plots, and whether they are still a reasonable estimate after cool inflation data will be key. Note, Fed speakers since the inflation data still noted two more hikes is a reasonable projection and Powell is likely to do the same. Many, including Goldman Sachs, see the Fed in an every-other-meeting stance, implying a skip in September, and then deciding what to do in November based on the data - but markets and economists primarily expect July to be the last hike with many forecasting a continued cooling of inflation. Recent data has shown an easing of price pressures alongside a resilient economy, although there has been some loosening in the labour market, it is still above pre-COVID averages, and the slowdown is not enough to signal an immediate recession. When combining the data, it supports the argument of a soft landing. However, it is worth noting that although inflation is slowing, the Fed will be reluctant to declare victory just yet in case of a repeat of the 1970s, but Powell did previously state the balance of risks is now more balanced in terms of doing too much or too little.

Interest Rates: The Fed is widely expected to hike rates by 25bps in July after "skipping" in June, according to all 106 economists polled by Reuters, with markets also agreeing with this outcome, pricing in a 96% probability of a 25bp hike at the confab, and just a 4% chance of rates being left unchanged. With a 25bp hike seen as a given, attention will turn to any rate commentary guidance within the statement and from Fed Chair Powell in his press conference given there will be no updated forecasts at this meeting. On the statement, JPMorgan's Feroli does not expect any changes to the forward guidance about "determining the extent of additional policy firming that may be appropriate", and in the press conference Feroli will be looking for "Powell to indicate that the June dots are still informative, but that no decisions about the future have been made and that policy will remain data dependent". Commentary from Powell on the dot plots will be key, which looks for two more rate hikes this year (including July), but he is likely to reiterate any future decision will be data-dependent and he is unlikely to strongly commit to future rate decisions. Even since cool inflation data, Fed commentary has still been guiding us to two more rate hikes, but that has had little impact on market pricing. SGH Macro's Tim Duy expects the Fed Chair will take a similar tone to his colleagues, maintaining policy contours outlined in June, noting that one data point does not make a trend, while Duy also sees Powell emphasizing the Fed will update projections in September, but they can be revised up or down, depending on the data. Note, within the Reuters poll, only 19/106 economists see rates reaching the dot plot level.

Every-Other-Meeting: With the June decision seen as a skip, many see the Fed taking an every-other meeting approach, albeit Duy says this will not be confirmed by Chair Powell as he will not want markets to believe they are on a pre-determined path, and he also writes that Powell will not completely rule out a September rate hike. Powell is likely to stress data dependence and take it meeting-by-meeting, although he may be quizzed on Governor Waller's comment that the September meeting is a live one.

Fed Commentary & Recent Data: There has been a range of Fed views in recent commentary, where the most dovish appears to be Bostic, who noted he does not see the need for any more rate hikes this year given the effects of policy lags. Meanwhile, on the hawkish side, some like Mester and Logan noted they would have hiked in June, but understand why the Fed stood pat, and Mester noted her view on the dot plot is in line or a little bit above the median, but the majority have noted two more rate hikes this year seems appropriate. However, data has seen growth remain strong, a gradual easing of labour market strength, and cooling inflation, which has seen markets and economists look for just one more rate hike, although the Fed will likely want to see more evidence of cooling inflation before declaring victory, irrespective of recent data overall pointing towards a soft landing. The cooler inflation data will give the Fed some comfort following their June skip, and looking ahead analysts at Goldman Sachs expect the core inflation trend will have taken a decisive step down by the November meeting, convincing the FOMC a second hike is unnecessary following a skip in September, and marking July as the final hike of the cycle.

JPM Scenario Analysis/Reactions: JPMorgan's trading desk provides us with a scenario analysis, they see a 65% chance of a "Hike & Pause", expecting a hike in July with any further decisions being data dependent. JPM note that any language the market interprets that the Fed may pause after one hike, like commenting that the disinflationary progress has been faster than expected, should support bonds and stocks. JPM assign a 33-34% probability of a "Hike and Continue" message, noting several Fed speakers are in support of more hikes after July, and if inflation data reverses higher, the Fed may continue to tighten. The desk also provides some tail risks, with a 1-2% probability of a "Hawkish Skip", which would show the Committee listening to Fed dove Bostic. And even on a more dovish basis, it sees a less than 1% chance of a message that the "Fed Completing in May", leaving rates unchanged noting they had completed the tightening cycle in May. JPM expects, in response to the dovish tail risks, bull steepening to aid equities and weaken the dollar and boost commodity prices, but if they acknowledged they completed in May, the moves would be of a larger magnitude. Elsewhere, Danske Bank analysts note with markets only pricing in a few more bps of tightening post-July, the risks are skewed to the hawkish side if Powell keeps the door open for more hikes. Danske expects the immediate market reaction to be muted, but looking ahead it sees 10Y UST yields falling to 3.5% by year-end, and EUR/USD falling towards 1.06 by year-end.