Fed Unlikely To Pivot on Rates As Labor Market Remains Solid

Recession Appears Likely, but Can a 'Hard Landing' Be Avoided?

By Christine Cooper

The pace of the Federal Reserve's rate increases has spooked investors and brought equity markets ever lower in recent weeks, tumbling by 25% from the beginning of 2022. With losses of that magnitude, market participants have been betting on a "Powell put" in the near future, or the likelihood that Fed Chairman Jerome Powell and the other members of the Federal Open Market Committee would consider a change in tactics and ease up on rate hikes to stem further losses in equities.

But recent commentary from several FOMC members has been firm in committing to staying the course to bring inflation down, despite probably causing "some pain" in the economy. And September's jobs report, which showed continued strong hiring and an unemployment rate of 3.5%, the lowest in more than 50 years, put any remaining hopes for early easing to rest. Indeed, Wall Street is now expecting additional rate hikes of 125 basis points before the end of the year, and possibly 50 basis points in early 2023 bringing the policy rate to near 5%.

While economic activity has been slowing in response to rising rates, the labor market soldiers on. Despite anecdotal reports of firms threatening layoffs and hiring freezes, initial claims for unemployment insurance remain low, similar to monthly averages seen during the three years prior to the onset of the pandemic. And employers are still looking to hire workers for positions left empty during the pandemic, posting more than 10 million job vacancies on the last day of August.

Nevertheless, with interest rates rising and economic activity slowing, the economy is expected to fall into recession in early 2023, according to projections by Oxford Economics. In addition to slowing domestic activity, the sharp global economic slowdown and the strong U.S. dollar is expected to dampen U.S. exports and increase U.S. imports, placing a further drag on U.S. gross domestic product.

This will be somewhat offset by continued consumer spending as households are still sitting on high levels of savings accumulated during the pandemic and are returning to travel and restaurants, recreation that was largely curtailed over the past two years. As a result, any recession is likely to be relatively shallow — not quite a soft landing but also not a hard one.