Fed September Rate Decision

Fed starts the rate cutting cycle by reducing rates by 0.50%

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Fed Rate Decision Summary

Fed cuts 0.50%, expects 2 more 0.25% cuts in 2024 and 4 cuts in 2025

After reaching the 5.25%-5.50% peak of the current rate cycle July of last year, the highest level for over 20 years, the Fed has started its rate cutting cycle by reducing rates by 0.50% to a range of 4.75%-5.00%. Only a week ago, financial market pricing had implied just a 0.25% cut in rates, but this shifted towards the 0.50% level over the past few days. Still, just before the announcement, market pricing did not indicate a clear choice between 0.25% and 0.50% so the actual decision was eagerly anticipated.

Fed Chairman Powell explained the decision to cut by 0.50% by saying the Fed wants to ensure that the strength in the labor market can be maintained. He pointed out that economic activity continues to expand at a solid pace and consumer spending remains resilient and that even though labor market conditions have cooled, overall employment levels are still strong and near full employment. The Fed thinks the labor market is still very solid, but the downside to employment has increased. By cutting by 0.50%, the Fed shows a commitment to make sure it does not fall behind in supporting the labor market and economy.

The updated economic projections and updated "dot plot" show Fed members believe there could be a further 0.50% in rate cuts this year and then a further 1.0% in rate cuts in 2025. During the press conference Chairman Powell stated that the 0.50% initial cut should not be seen as the new pace of rate cuts. Normally, the Fed cuts rates in 0.25% increments so putting everything together, this implies rate cuts of 0.25% at the upcoming November and December meetings, and then cuts of 0.25% every other meeting in 2025.

The Fed still believes it can manage a soft-landing of the economy, and that the 0.50% initial rate cut will help to achieve that. Updated economic projections show the Fed expects GDP growth of 2% over the coming years. And for the unemployment rate to rise slightly from the current 4.2% to 4.4% by the end of this year and to stay at that level in 2025 before declining thereafter.

The two main questions by raised by the Fed cutting by 0.50% are, 1) does this mean a soft-landing of the economy is more likely?, and 2) Does it mean inflation starts rising again?

- Even though historically, Fed rate cutting cycles have normally been followed by recessions, we believe the Fed is in a good position to manage a soft-landing of the economy this time around. The next few months will be critical as a sharp deterioration in the labor market would indicate things are worse than the Fed expects. If the unemployment rate can remain steady or increase just slightly (up to 4.4%) then the outlook would look much better from the Fed's perspective.
- On inflation, we believe by cutting rates aggressively at first, this could increase upward inflation pressures in the future. Consumers have been waiting for rate cuts to begin and this could spur higher consumption and inflation in the future. Any signs that inflation is re-accelerating would not be welcome by the Fed and could lead to a slowdown or even reversal in rate cuts.

Financial markets will have to digest the Fed's moves and outlook. We see a few implications:

- Market implied pricing still has nearly 3 further cuts for this year and 8 further cuts in total through 2025, which is above the Fed's expectations of 2 cuts this year and 6 cuts in total through 2025. We believe market pricing is too pessimistic on the economy and rate cut expectations will need to come down toward Fed levels. And since there are higher risks of inflation returning, rate cut expectations will need to be tempered. All this means Treasury yields could actually rise from current levels as they seem too low if a recession is not likely.
- Equity markets should benefit from the higher chances of a soft-landing being achieved. Equity markets should also benefit from the lower Fed rates. However, US equities are near record highs and if Treasury yields rise from current levels, this could be a headwind for equities so we expect continued equity volatility for now.

Source: Bradesco – September 2024

Dot Plot shows Fed expects 4 cuts in total in 2024 and a further 4 cuts in 2025

Fed "Dot Plot" September vs June

- Fed cut rates by 0.50% and expects a further 0.50% in cuts this year, implying 0.25% cuts at the November and December meetings.
- The Fed then expects a further 1% in cuts in 2025 (same as the June meeting), or 0.25% in cuts every other meeting.
- Fed expects rate to reach 2.75%-3.0% in 2026 and beyond, slightly above the previous outlook for 2.75% in the longer-run.

June "Dot Plot", 5.125% in 2024, 4.125% in 2025

	2024	2025	2026	Longer run
5.500%				
5.375%	****	*		
5.250%				
5.125%	*******			
5.000%				
4.875%	********	*	*	
4.750%				
4.625%				
4.500%				
4.375%		****		
4.250%				
4.125%		********	*	
4.000%				
3.875%		**		
3.750%				*
3.625%		*	***	*
3.500%				**
3.375%			***	
3.250%				
3.125%			*******	*
3.000%				****
2.875%		*	**	
2.750%				***
2.625%			*	*
2.500%				*****
2.375%			*	*
2.250%				
2.125%				

September "Dot Plot", 4.375% in 2024, 3.375% in 2025

	2024	2025	2026	2027	Longer run
5.500%					
5.375%					
5.250%					
5.125%					
5.000%					
4.875%	**				
4.750%					
4.625%	*******				
4.500%					
4.375%	*********				
4.250%					
4.125%	*	*			
4.000%					
3.875%		*	*	*	
3.750%					*
3.625%		***	***	***	*
3.500%					**
3.375%		******	***	***	**
3.250%					*
3.125%		******	**	**	
3.000%					**
2.875%		**	******	*****	**
2.750%					***
2.625%			***	***	*
2.500%					***
2.375%			*	**	*
2.250%					
2.125%					

Source: US Federal Reserve/Bradesco – 18 September 2024

Economic Projections

Fed’s Economic Outlook September vs June

- Fed outlook is for a soft-landing of the economy, which is supported by the initial 0.50% rate cut at the September meeting.
- The Fed expects GDP growth to be maintained at 2% over the coming years, which is slightly above the long-run estimate of 1.8% for the economy.
- The unemployment rate is expected to rise to 4.4% this year and stay at that level in 2025 before declining. Even the higher end of the range calls for just 4.7% unemployment in 2025, which is relatively low by historic standards and does not indicate recessionary levels.
- Inflation is expected to continue moderating with Core PCE down to 2.2% in 2025 before reaching the target level of 2% in 2026.

Fed’s Economic Outlook: A soft-landing outlook with GDP growth of 2% and unemployment rising slightly to 4.4%

	Median					Central Tendency					Range				
	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run
Change in real GDP	2.0	2.0	2.0	2.0	1.8	1.9-2.1	1.8-2.2	1.8-2.3	1.8-2.1	1.7-2.0	1.8-2.6	1.3-2.5	1.7-2.5	1.7-2.5	1.7-2.5
Jun Projection	2.1	2.0	2.0		1.8	1.9-2.3	1.8-2.2	1.8-2.1		1.7-2.0	1.4-2.7	1.5-2.5	1.7-2.5		1.6-2.5
Unemployment Rate	4.4	4.4	4.3	4.2	4.2	4.3-4.4	4.2-4.5	4.0-4.4	4.0-4.4	3.9-4.3	4.2-4.5	4.2-4.7	3.9-4.5	3.8-4.5	3.5-4.5
Jun Projection	4.0	4.2	4.1		4.2	4.0-4.1	3.9-4.2	3.9-4.3		3.9-4.3	3.8-4.4	3.8-4.3	3.8-4.3		3.5-4.5
PCE Inflation	2.3	2.1	2.0	2.0	2.0	2.2-2.4	2.1-2.2	2.0	2.0	2.0	2.1-2.7	2.1-2.4	2.0-2.2	2.0-2.1	2.0
Jun Projection	2.6	2.3	2.0		2.0	2.5-2.9	2.2-2.4	2.0-2.1		2.0	2.5-3.0	2.2-2.5	2.0-2.3		2.0
Core PCE inflation	2.6	2.2	2.0	2.0		2.6-2.7	2.1-2.3	2.0	2.0		2.4-2.9	2.1-2.5	2.0-2.2	2.0-2.2	
Jun Projection	2.8	2.3	2.0			2.8-3.0	2.3-2.4	2.0-2.1			2.7-3.2	2.2-2.6	2.0-2.3		
Projected appropriate Policy Path:															
Federal funds rate	4.4	3.4	2.9	2.9	2.9	4.4-4.6	3.1-3.6	2.6-3.6	2.6-3.6	2.5-3.5	4.1-4.9	2.9-4.1	2.4-3.9	2.4-3.9	2.4-3.8
Jun Projection	5.1	4.1	3.1		2.8	4.9-5.4	3.9-4.4	2.9-3.6		2.5-3.5	4.9-5.4	2.9-5.4	2.4-4.9		2.4-3.8

Source: US Federal Reserve/Bradesco – 18 September 2024

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