September 18, 2024

U.S. Fed cuts 50 basis points with more reductions to come

- Debate ahead of the Fed's decision was not whether to cut but by how much - and policymakers opted to deliver a 50 basis point reduction that was close to market pricing ahead of the report, but larger than the 25 bp cut we assumed (and larger than initial 25 bp cuts from the BoC, BOE, ECB, and other advanced economy central banks)
- It is not clear that the size of the September interest rate cut will be repeated. The accompanying 'dot plot' shows the median FOMC participant expects another 50 bps of cuts this year (consistent with 25 basis point reductions at each of the November and December policy meetings.)
- But the direction is still clearly lower - with 75 basis points more cuts now expected by end of 2025 than expected in June. The total 200 basis points of cuts the FOMC assumes by end of next year, including today's cut, is larger than the 125 basis point reduction in our own base case.
- Chair Powell reinforced in the press conference that policy decisions would be made on a meeting by meeting basis, and the larger than 'normal' cut to start this easing cycle is consistent with the view of Fed officials that it is better to front-load monetary policy moves when they are needed. The expected low for this cutting cycle is still around 3% in 2026.
- The rate statement and comments from Fed Chair Powell emphasized that the 50 bp cut was not the Fed panicking with the economic growth backdrop still characterized as "solid." Chair Powell said explicitly in his press conference that he does not see the probability of a recession as elevated.
- But inflation projections were revised slightly lower and unemployment rate projections higher - the unemployment rate is projected to end this year at 4.4% (versus 4.0% expected as of June). Powell reinforced in the press conference that labour markets have now essentially normalized so further slowing is not welcomed by policymakers.
- **Bottom line:** The Fed took pains to reinforce the view that this initial 50 basis point cut is the beginning of a "recalibration" cycle -designed to keep the economy in a strong pace rather than a response to rapid softening in the economic growth backdrop. But monetary policy

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impacts the economy with a lag and concern has clearly increased that the larger than 'normal' interest rate cut today was needed to reduce the risks of falling too far behind what has, for now, been a very gradually softening labour market. While downside risks remain, we continue to expect (similar to the Fed) that labour markets will continue to gradually soften but not falter, and for the Fed to follow with further gradual interest rate cuts.

FOMC projections summary

	Current (Sept) projections		
	2024	2025	2026
GDP growth	2 (2.1)	2 (2)	2 (2)
PCE deflator	2.3 (2.6)	2.1 (2.3)	2 (2)
Core PCE deflator	2.6 (2.8)	2.2 (2.3)	2 (2)
Unemployment rate (Q4)	4.4 (4)	4.4 (4.2)	4.3 (4.1)
Appropriate EOY fed funds rate	4.4 (5.1)	3.4 (4.1)	2.9 (3.1)
Change in bps	-50.0	-100	-50

*Previous median in parentheses

Source: Haver, RBC Economics