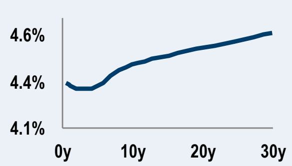
Dec 18, 2024

A LONG ROLLOUT

- Federal Reserve policymakers cut overnight interest rates by 0.25% to a range of 4.25% - 4.50%, the third consecutive rate cut in 2024
- With inflation slightly warm in recent months and growth data trending strong, expect FOMC to downshift the pace of cuts in 2025
- Statement language was little changed save for text indicating that the FOMC is now thinking about when to stop cutting rates
- Dot plot now has a median of two rate cuts in 2025, which is down from four at the prior release; we are anticipating just two

Treas.	2.30PM	1.45PM	Chg.
3mo	4.35	4.34	+0.00
2yr	4.31	4.22	+0.09
5yr	4.32	4.24	+0.08
10yr	4.44	4.39	+0.05
30yr	4.62	4.60	+0.02
3m/2s	(4)	(12)	+8
2s/10s	13	17	-(3)
2s/30s	31	37	-(7)



Source: Bloomberg

The Federal Reserve Open Market Committee (FOMC) reduced its target for interest rates by 0.25% to a range of 4.25% – 4.50%, and something of a pattern is beginning to emerge. That pattern? At the risk of extending our aircraft metaphor beyond its welcome, the pattern is land the plan firmly, apply the brakes gently, then roll out slowly. The landing was our first 50, the brakes were the consecutive 25s, and the roll out looks to be at a pace of just 25 per quarter for the first half of the new year. That would put the end of the current cuts at a midpoint of 3.875% and make it look far more like a "mid-cycle adjustment" than any sort of policy accommodation—provided, of course, that growth remains reasonably constructive.

Data since the FOMC met in November has generally noted strong growth and warm inflation. For 4Q, growth is running somewhere in the low-3% range thanks to a strong (if late) start to the holiday season. After a weather-related dip, employment rebounded in Nov., leaving the 3-month average payroll gains at +173K, only about 10% slower than the similar period last year. The warm inflation includes four consecutive months of core CPI readings at +0.3%, a notable upshift from the summer's mild pace. The Fed's preferred core PCE is running at a +2.7% annualized rate from Aug - Nov (incl our assumptions for this month), notably higher than the 2.0% long run target. Unlike in other recent periods of inflation uptick, there's no single sector on which to pin the increases; instead, the slightly toasty readings are widespread. We anticipate, however, that housing-related inflation components will downshift slightly into 2025, and it seems Fed officials are implicitly counting on the same in order to pencil in rate cuts for the new year. Housing inflation has, however, remained stubbornly persistent despite outward indications that it should be decelerating.

The FOMC statement accompanying today's rate cut was relatively little changed, continuing the FOMC's trend of using economic projections and the dot plot to make members' opinions known at these quarterly meetings. In fact, the sole change to the December statement was a modification indicating policymakers are approaching the final leg of their planned easing. Additional cuts are still likely, but the FOMC is considering "the extent and timing of" said cuts, a clear reference to greater uncertainty ahead.

December's update to economic projections includes a slight upgrade to growth expectations and a material increase to inflation expectations for 2025. Based on the distribution of forecasts, it seems that some more pessimistic Fed officials have reduced their perceptions of recession risk, but nearly all officials are considering greater inflation risk. The "central tendency" of core PCE inflation forecasts for 2025 is now 2.5% - 2.7%, far away from the Fed's target. Barring any growth shocks, that means that policy will need to remain restrictive deep into next year as well. That development in the outlook seems to be the most jarring. The dot plot component of the economic projections downgraded expected 2025 cuts to a median of two, a bit more gradual than markets, which were pricing three cuts heading into today's announcement.

The December rate cut was baked in, and with interest rate markets pricing a 1-in-6 chance of a January cut, the guidance about a slower pace is no surprise either. Initial market response was quite negative, however, with the dollar rallying sharply (about 0.5%), yields rising (5-10 bps depending on maturity), and equity markets stumbling (S&P 500 -0.7%) compared to pre-release levels.

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FEDERAL RESERVE press release

• There were no changes to the economic language this time around

Recent indicators suggest that economic activity has continued to expand at a solid pace. Since earlier in the year, labor market conditions have generally eased, and the unemployment rate has moved up but remains low. Inflation has made progress toward the Committee's 2 percent objective but remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

• FOMC not to consider "extent and timing" of cuts, a signal that we're in the later phases of this cutting process

In support of its goals, the Committee decided to lower the target range for the federal funds rate by 1/4 percentage point to 4-1/4 to 4-1/2 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

• Hammack, new add to Cleveland Fed, dissents hawkishly

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Michelle W. Bowman; Lisa D. Cook; Mary C. Daly; Philip N. Jefferson; Adriana D. Kugler; and Christopher J. Waller. Voting against the action was Beth M. Hammack, who preferred to maintain the target range for the federal funds rate at 4-1/2 to 4-3/4 percent.

• Median growth forecasts bumped up a tenth for 2025, but core PCE inflation forecasts spiked +0.3% and now have upward skew in the central tendency

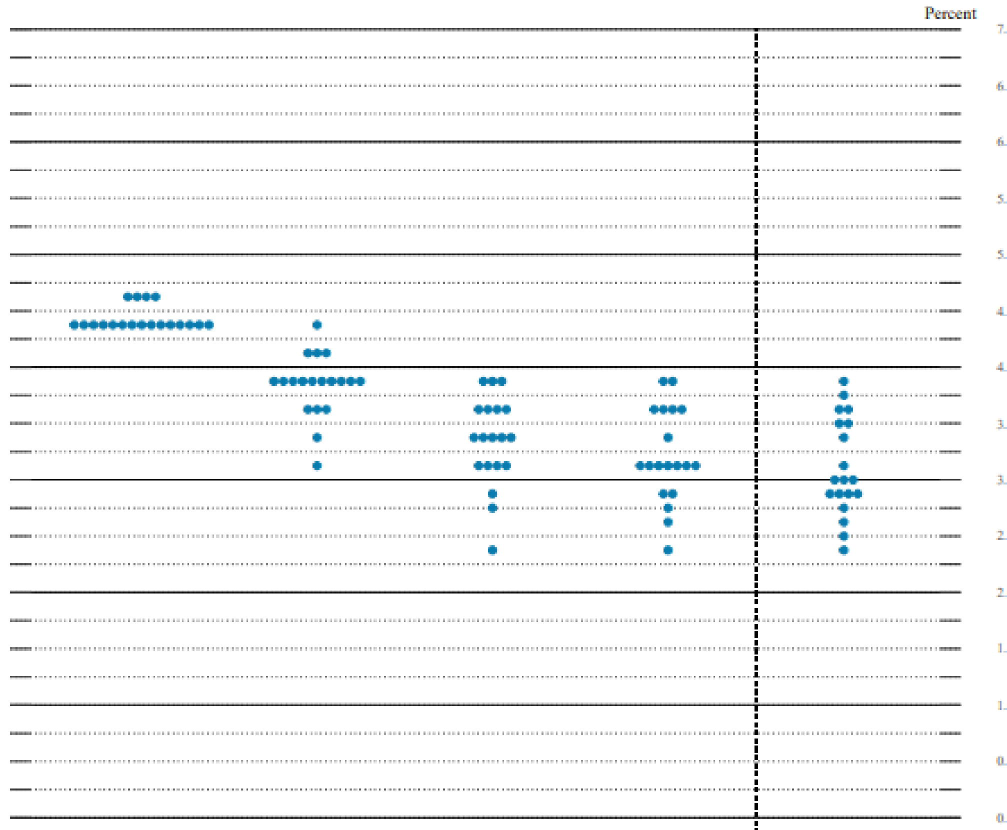
Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run
Change in real GDP	2.5	2.1	2.0	1.9	1.8	2.4–2.5	1.8–2.2	1.9–2.1	1.8–2.0	1.7–2.0	2.3–2.7	1.6–2.5	1.4–2.5	1.5–2.5	1.7–2.5
September projection	2.0	2.0	2.0	2.0	1.8	1.9–2.1	1.8–2.2	1.9–2.3	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
Unemployment rate	4.2	4.3	4.3	4.3	4.2	4.2	4.2–4.5	4.1–4.4	4.0–4.4	3.9–4.3	4.2	4.2–4.5	3.9–4.6	3.8–4.5	3.5–4.5
September projection	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
PCE inflation	2.4	2.5	2.1	2.0	2.0	2.4–2.5	2.3–2.6	2.0–2.2	2.0	2.0	2.4–2.7	2.1–2.9	2.0–2.6	2.0–2.4	2.0
September projection	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
Core PCE inflation[4]	2.8	2.5	2.2	2.0		2.8–2.9	2.5–2.7	2.0–2.3	2.0		2.8–2.9	2.1–3.2	2.0–2.7	2.0–2.6	
September projection	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	
Memo: Projected appropriate policy path															
Federal funds rate	4.4	3.9	3.4	3.1	3.0	4.4–4.6	3.6–4.1	3.1–3.6	2.9–3.6	2.8–3.6	4.4–4.6	3.1–4.4	2.4–3.9	2.4–3.9	2.4–3.9
September projection	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

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate

• Dot plot has 3x cuts in 2025 (about in line with market expectations) but some outliers to the downside

• Policy expectations in future years are all over the map but generally 0.2% - 0.4% higher than at the Sept FOMC meeting



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