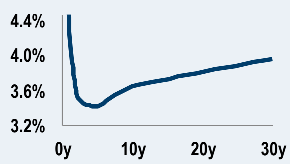
Sept 18, 2024

LANDING THE BEAST

- Federal Reserve policymakers cut overnight interest rates by 0.50% to a range of 4.75% - 5.00%, the first move and a big one at that
- The statement accompanying today's decision offered little forward guidance, but highlighted the shift towards a more balanced policy
- Even as the Fed opted for a larger cut, the skew in future rate forecasts hints that more rather than fewer cuts are likely
- Dot plot now has a median of two more 0.25% cuts in 2024 and four 0.25% cuts in 2025, largely in line with consensus expectations

Treas.	Now	1.45PM	Chg.
3mo	4.79	4.80	-(0.01)
2yr	3.59	3.64	-(0.05)
5yr	3.46	3.47	-(0.01)
10yr	3.68	3.68	-(0.00)
30yr	4.00	3.99	+0.01
3m/2s	(120)	(116)	-(4)
2s/10s	9	4	+5
2s/30s	41	35	+6



Source: Bloomberg

The Federal Reserve Open Market Committee (FOMC) reduced its target for interest rates by 0.50% to a range of 4.75 – 5.00%, kicking off the hiking cycle with a bang. Thus marks the third stage of the process begun two months ago: foam the runway (July FOMC), check the foam (August Jackson Hole Conference), and land the beast (Sept FOMC). Today's 0.50% cut means Federal Reserve (Fed) officials are trying to bring it down aggressively, the tactical rationale being that a firm touchdown is the safest course of action when economic crosswinds are particularly blustery. When policy rates are far away from neutral, an aggressive approach is, in Fed thinking, safer. Moreover, the skew of future Fed outcomes beyond today's cuts looks surprisingly dovish.

Data since the FOMC met in July has pointed towards strong output, slowing job growth, and easing inflation. Core GDP growth for 2Q measured +2.9%, a very healthy pace, and most estimates for 3Q have growth trending similarly. At this point, it is almost arithmetically impossible to have a contraction until early 2025, and that is very much a "maybe." Job growth has meanwhile been decelerating, with the three-month average of payroll gains falling to 116K as of August, the lowest reading since the pandemic. Since labor markets are the source of consumer income, slower job growth clearly poses a risk, but it is not in and of itself significant enough to herald a recession. Inflation, meanwhile, continues to slow and, just as importantly, become less volatile. Through August, it looks like the 3-month annualized rate of core PCE inflation will measure 1.9 – 2.0%, which is the third such month of a similar run rate. In our view, there is a greater chance core inflation will fall below the Fed's 2.0% target than going above 2.5% next year.

While today's rate reduction was on the higher side of market expectations, the key is not the bigger cut, but rather the odds of big moves in the future. To latch on to our lengthy metaphor, the firm touchdown means fewer bounces in coming quarters. In terms of the FOMC statement, the Fed acknowledge that "job gains have slowed." More significant is that the FOMC now "has greater confidence that inflation is moving sustainably towards 2 percent," which is enough to launch an apparently aggressive cutting cycle. Finally, the statement took balance of risks language that first came from Powell's Nov 2023 press conference and put it into action in the forward guidance passage, giving equal verbiage to "supporting maximum employment" and returning inflation to target.

September also brings with it the quarterly update to policymaker forecasts and rate expectations. For this quarter, Fed officials marked up their 2024 growth expectations and marked down their future inflation expectations. Similarly, they marked-to-market the dot plot with two additional 0.25% cuts in 2024 and four 0.25% cuts in 2025. That change puts the median dot at 3.375% by the end of next year, which is less accommodation than the markets currently have priced. However, the skew in the dots suggests that the most likely alternative to the base case is that the cuts are more, not less-aggressive. Eight policymakers, for example, have rates below the 2025 median, but only five have it above that level.

Immediate market response to the FOMC statement had yields lower on the front end of the curve but about unchanged on the long end, a sizeable round of intraday steepening. With the Bank of England and Bank of Japan still on tap for this week, it is worth waiting a few days to see how strong the steepening impulse proves to be.

FEDERAL RESERVE press release

• Downgrade on jobs, more confidence in inflation

• Guidance now includes even weighting to jobs and inflation; comments from Fed officials suggest jobs are the bigger concern right now

• Michelle Bowman dissented hawkishly, a rare instance of a Fed Governor disagreeing with the consensus

Recent indicators suggest that economic activity has continued to expand at a solid pace. Job gains have slowed, and the unemployment rate has moved up but remains low. Inflation has made further 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 has gained greater confidence that inflation is moving sustainably toward 2 percent, and 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.

In light of the progress on inflation and the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/2 percentage point to 4-3/4 to 5 percent. In considering 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.

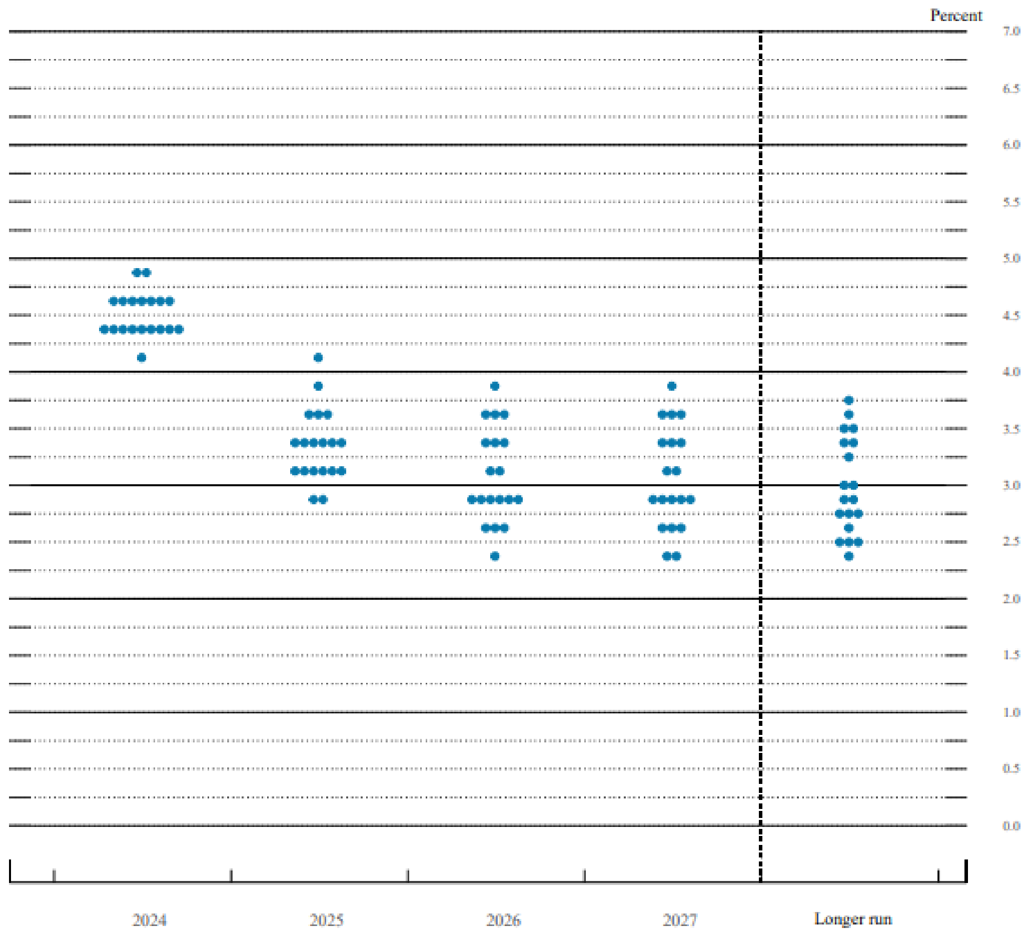
Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Thomas I. Barkin; Michael S. Barr; Raphael W. Bostic; Lisa D. Cook; Mary C. Daly; Beth M. Hammack; Philip N. Jefferson; Adriana D. Kugler; and Christopher J. Waller. Voting against this action was Michelle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

- Median growth forecasts slightly downgraded, but so are core inflation forecasts for '24 and '25

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	2.0	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
June 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
June 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
June 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[4]	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	
June 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		
Memo: 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
June 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

- Dot plot has 2x more 0.25% cuts for 2024, 4x 0.25% cuts in 2025
- Just as important as the median is the clear downward skew, with more participants thinking cuts
- The "longer term" dot went up slightly, another hint that neutral interest rates in the US are creeping higher



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