Fed Watch

AIB Treasury Economic Research Unit

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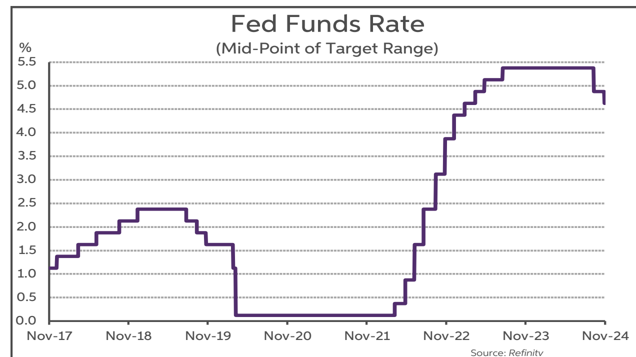
Fed cuts by 25bps, Powell emphasises independence

The November meeting of the US Federal Reserve Open Market Committee (FOMC) saw the central bank cut interest rates for the second consecutive time. The target range for the Fed funds rate was reduced by 25bps to 4.50-4.75%. The decision by the FOMC to cut rates by 25bps was unanimous, following a split on the FOMC for September's bumper 50bps cut. Markets were teed up for a rate cut, with little change to futures contracts in the aftermath of the statement and press conference.

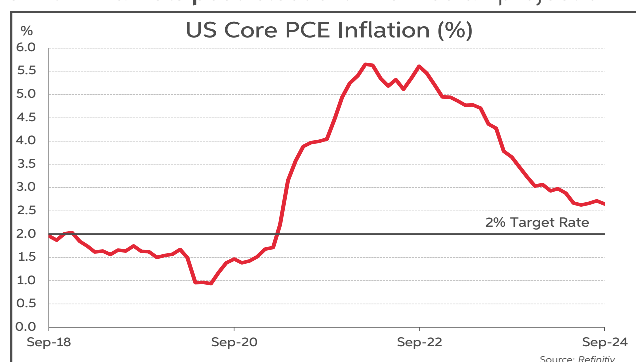


The FOMC statement contained minimal changes from recent statements, outlining the rationale for the decision to cut rates in the context of its dual mandate (i.e. maximum employment and stable prices). It noted that "the risks to achieving its employment and inflation goals are roughly in balance", mirroring the shift away from inflation concerns in recent statements.

In the post-meeting press conference, Fed Chair Powell elaborated further on the FOMC's decision. He again emphasised that policy would move gradually from here, stating "the right way to find neutral is carefully", but he also appeared relaxed on recent trends in inflation, referring to the stickiness earlier in the year as "catch-up inflation". The FOMC forecasts from September show, core-PCE, the Fed's preferred inflation gauge, is forecast to print at 2.6% by end year (was 2.8%) and is projected to be 2.2% in Q4'25 (was 2.3%). The Fed continues to expect core inflation to be at its 2% target by end 2026. Meanwhile, the unemployment rate forecast was revised higher to 4.4% (from 4.0%) and it is seen as remaining at this level through 2025, before edging down to 4.3% by Q4'26 and to 4.2% by end'27. The Fed's GDP forecast for Q4'24 was revised down marginally to +2.0% y/y (from 2.1%), while it continues to anticipate the economy to grow at a 2% rate over the remainder of its forecast horizon. Given the strength of GDP growth in Q3 2024, the FOMC may have to revise near term growth forecasts higher in December.

On the impact of the incoming President on monetary policy, Fed Chair Powell played a straight bat, stating "we don't guess, we don't speculate and we don't assume". However, he was more forthright when questioned on whether he would step down if asked to do so by the next Administration, firmly stating "No" and highlighting the protections for Fed officials in law. This was a timely reminder of the Fed's independence following speculative opinion pieces on the future of the central bank in the aftermath of the election. However, markets have firmly shifted in recent weeks, pricing in higher inflation and less Fed rate cuts in the near term.

In this context, the updated interest rate projections (i.e. dot plot) from the Fed at the December meeting will be closely watched to determine if officials have internalised the shift in markets post-election. The median projection in September was that rates would decline to a 4.25-4.50% range by year end. In other words, a further 25bps rate cut in December. Rates are seen as being cut by a further 100bps in 2025 and by 50bps in 2026, falling to a 2.75-3.00% range. The Fed projected 250bps in cumulative easing in September, which compared to 225bps in the June 'dots'.



Futures contracts were little changed post the statement, following significant moves around the election. The market expects a less aggressive pace of rate cuts over the next year, envisaging a further 25bps cut in December to bring the fed funds range to 4.25-4.50% by end year; and to reach their trough around 3.50-3.75% by end 2025. **In the near term, a further 25bps cut in December seems a reasonable expectation, assuming the softening in US labour market conditions continues. However, there is now greater uncertainty on the medium term path of monetary policy, given the potential for significant changes in US trade, economic and fiscal policy from next year.**

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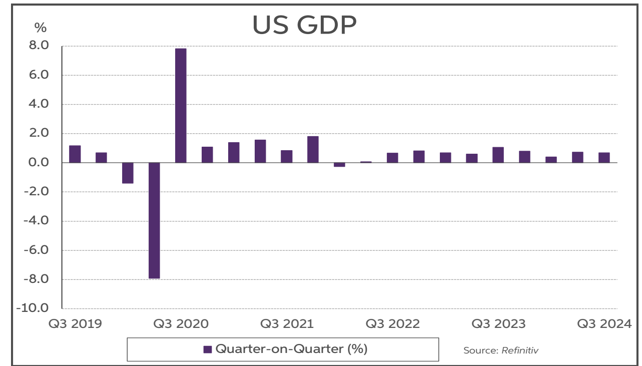
US economy maintains strong growth in 2024

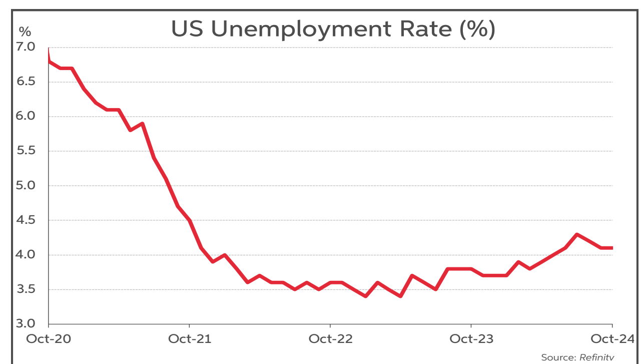
The US economy registered the fastest growth of the G7 in 2023, with GDP rising by 2.7%. Furthermore, the economy has continued to perform very strongly in the first three quarters of this year. GDP expanded by 1.6% annualised in Q1, with growth accelerating to 3.0% and 2.8% annualised, respectively, in Q2 and Q3. **Regarding the underlying breakdown of GDP in Q3, consumption and a sharp increase in government spending were the main drivers of growth.** Consumption rose by a rapid 3.7% annualised pace, adding 2.5 percentage points (p.p.) to GDP. Similarly, government expenditure jumped by 5%, largely owing to higher defence spending, contributing 0.9 p.p. to the total. Elsewhere, a solid increase in the non-residential category (+3.3%) was once again undercut by a decline in residential activity (-5.1%), meaning that investment added a meagre 0.2 p.p. to output. Meantime, imports continued to grow at a faster pace than exports, resulting in net trade knocking a hefty 0.6 p.p. from growth. Changes in inventories clipped 0.2 p.p. from GDP.



In terms of the labour market, conditions appear to have softened, albeit the data have been somewhat volatile recently. In the first seven months of the year, the unemployment rate was on an upward trajectory (partly due to an increase in the size of the labour force), rising to 4.3% in July from 3.7% at the start of the year. However, it has printed at 4.1% in both September and October. Meanwhile, the pace of payroll expansion has slowed, averaging around 148k per month in Q2 and Q3, compared to 267k per month in Q1. Furthermore, payrolls rose by just 12k in October, amid storms and industrial action. At the same time, there are signs that labour demand is waning. The number of job openings declined to 7.4m in September, down from 8.7m at the start of the year. Amid the softening in labour demand, average earnings growth has slowed but remains elevated. It printed at +4.0% y/y in October, up from +3.9% in September, but below the +4.4% rate registered in January. The closely followed wages component of the employment cost index increased by 0.8% in Q3, down from +0.9% in Q2.

Like-wise, the inflation data have been somewhat noisy in recent months. Headline CPI inflation has been falling since March, printing below 3% in July, before nosediving to 2.5% in August, and back to 2.4% in September. Meantime core-CPI inflation slowly dissipated in the first seven months of the year, edging lower to 3.2% in July from 3.9% in January. However, it remained at 3.2% in August before rising for the first time since March 2023, to 3.3% in September. Similarly, core-PCE had been falling slowly, inching down to 2.6% in June, its lowest level since March 2021. It rose to 2.7% in July though and remained at that level throughout the remainder of Q3.

Meanwhile, the limited data for October have been mixed. The services sector continues to outperform, with both the PMI and the non-manufacturing ISM firmly in expansion mode in the month. In contrast, manufacturing remains weak, with the sector PMI and ISM both staying in contraction mode in October. Elsewhere, the Conference Board measure of consumer confidence rose to its highest level since January, although, the Michigan measure was little changed.



To summarise, the economy came into 2024 in rude health, on the back of strong growth, a tight labour market and falling inflation last year. Furthermore, these trends have largely stayed intact this year. The US has maintained strong growth in the first three quarters of the year, despite the lagged effect of higher interest rates. Although there has been a clear softening in the labour market (notwithstanding the volatility in the data), it should be noted that the unemployment rate remains very low, at 4.1%. Meanwhile, disinflation is still a feature of the US economy, despite it waning recently. Against this backdrop, the Fed has cut rates by 75bps. However, monetary policy is still tight, meaning that there is scope to lower rates further to support the economy if needed. **Overall, the IMF expects US GDP to expand by 2.8% this year and 2.2% in 2025.** Longer-term though, there remains a level of uncertainty surrounding the US economic outlook. President-elect Trump has proposed a number of policies (tax cuts, restricted immigration, tariffs) which are likely to add significantly to an already yawning fiscal deficit, and to inflation. The policies may also restrict the level of rate cuts from the Fed.

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