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Not behind the curve

FOMC Post-Meeting September 2024

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Summary

- Today, the FOMC cut the target range for the federal funds rate by 50 bps, from 5.25-5.50% to 4.75-5.00%.
- During the press conference, Powell had trouble clearly explaining the reason for the large cut, because he did not want to admit that this 'recalibration' was needed because the FOMC had fallen behind the curve.
- Meanwhile, the large cut seemed counterintuitive to the repeated claim that the economy was strong. The recalibration argument is clashing with the message this large cut sends.
- What's more, with a 50 bps cut without compelling data or forecasts the Fed is taunting former and possibly next President Trump. This could have serious repercussions next year. The sole dissenter, Michelle Bowman, may just have improved her chance of becoming the next Fed Chair.
- Looking ahead, if this was truly a recalibration and 50 has not become the new 25, we still expect 25 bps at each of the three upcoming scheduled meetings in November, December and January.
- What happens after January will to a large extent depend on the economic policies of the next administration. A Trump victory would likely lead to a universal tariff and a rebound in inflation that should stop the Fed's cutting cycle in its tracks. A Harris victory would likely be less inflationary and give scope for additional rate cuts in 2025.

Introduction

Today, the FOMC cut the target range for the federal funds rate by 50 bps, from 5.25-5.50% to 4.75-5.00%. Almost an hour prior to the decision, markets priced in a 58% probability of 50 bps and a 42% probability of 25 bps. Based on the economic data, we expected only 25 bps at this meeting. In the past, the Fed only cut 50 bps at the start of a cutting cycle in case of a severe deterioration in the economy or markets, such as the dot com bubble and the Global Financial Crisis. However, the continued lack of guidance on the size of today's rate cut suggested that it was a close call. Hence the title *Casino* of our preview. During the press conference, Powell had trouble clearly explaining the reason for the large cut, because he did not want to admit that this 'recalibration' was needed because the FOMC had fallen behind the curve. Meanwhile, the large cut seemed counterintuitive to the repeated claim that the economy was strong.

Statement

According to the FOMC statement, job gains have "slowed" (instead of "moderated"). The statement repeated that inflation has made further progress toward the Committee's 2 percent objective but added: "but remains somewhat elevated." 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. 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. The Committee is strongly committed to supporting maximum employment (this was added) and returning inflation to its 2 percent objective. 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.

Press conference

If there was a strong case for a 50 bps cut, Powell did not make it at his press conference. He repeatedly stressed that the US economy was strong, but we should see the strong move as a commitment to keep the economy strong.

- Doctor: "We'll give you extra strong medication."
- Patient: "Is my condition that bad?"
- Doctor: "No, you're healthy, but we're committed to keep you healthy."

In the end, it looks like Powell felt the level of the policy rate was out of sync with the progress on inflation and the rise in the unemployment rate. After all, he used the word 'recalibration' several times. This was also evident in the FOMC projections now showing a 100 bps reduction compared to the pre-meeting level of the target range, rather than the 25 bps in the June projections. Although Powell denied that the Fed had fallen behind the curve, this is exactly what recalibration means. However, the latter obscures the former and Powell did not want to admit that they should have cut 25 bps in July. It got really funny when he said that the FOMC had been patient in waiting and this allowed them to make a strong move. Yes, if you get behind the curve, you have to make a big leap forward to catch up!

Still, **the recalibration argument is clashing with the message this large cut sends**. When asked during the Q&A what his message to the US consumer is, Powell said that the US economy is in a good place and our decision is to keep it there. Really? A 50 bps cut as a message that the economy is strong? So if they cut by 75 bps the economy is booming? This sounds like something out of George Orwell's *1984*:

- WAR IS PEACE
- FREEDOM IS SLAVERY
- IGNORANCE IS STRENGTH.

Understandably, a reporter asked whether the 50 bps cut meant that he was more concerned about the labor market than about inflation. However, Powell denied this and said that the risks are roughly balanced. This exchange underlined the problem.

Projections

In his prepared speech at the post-meeting press conference, Fed Chair Powell said that lower inflation and higher unemployment had led to lower fed funds rate projections. With the unemployment rate currently at 4.2% (August), the FOMC expects it to rise to 4.4% in the final quarter of this year and remain there through 2025, before declining slowly to its longer run value of 4.2%. So according to the FOMC, unemployment is now at its longer run value and will only rise 0.2 ppt above it. This does seem a bit optimistic. Meanwhile, inflation projections for 2024 and 2025 were revised downward, and before the end of 2026 inflation will be at its 2.0% target. The GDP growth projection for 2024 was revised downward slightly, but the remainder of the growth trajectory remained unchanged. The biggest changes were in the rate projections. The federal funds rate for the end of 2024 was revised downward from 5.1% to 4.4%. This is where Powell's recalibration is coming from. To get there in three scheduled meetings, i.e. 100 bps below the pre-meeting level of 5.4%, at least one rate cut of 50 bps was needed and Powell wanted it to be the first. The pace is likely to slow down in 2025 with 100 bps for the whole year, followed by 50 bps in 2026. The FOMC expects to end at 2.9% before the end of 2026 and no further cuts in 2027. This is supposed to be the longer run level of the fed funds rate.

Table 1: Median projections of FOMC participants, September 2024

Variable	*2024*	*2025*	*2026*	*2027*	*Longer run*
GDP growth	2.0 (2.1)	2.0 (2.0)	2.0 (2.0)	2.0	1.8 (1.8)
Unemployment	4.4 (4.0)	4.4 (4.2)	4.3 (4.1)	4.2	4.2 (4.2)
PCE inflation	2.3 (2.6)	2.1 (2.3)	2.0	2.0	2.0 (2.0)
Core PCE inflation	2.6 (2.8)	2.2 (2.3)	2.0 (2.0)	2.0	
Federal funds rate	4.4 (5.1)	3.4 (4.1)	2.9 (3.1)	2.9	2.9 (2.8)

Source: FOMC, September 18, 2024 (June 12, 2024)

Conclusion

Powell had a clear incentive to deliver a 50 bps cut before Election Day, because Trump has already made clear that he would not reappoint him as Fed Chair. In fact, he may decide to remove him prematurely. So Powell's only chance of another term is by pleasing Kamala Harris and her fellow Democrats in the Senate. In fact, on Monday three Democratic senators – Elizabeth Warren, Sheldon Whitehouse and John Hickenlooper – sent a letter to the Fed urging a 75 bps cut. However, the other voters in the FOMC should have seen the greater political risk to the institution from providing a jumbo cut without compelling support from the data or the forecasts just before the election. There was only one dissenter.

Although Powell's message was a mess, our argument for 50 bps would be the deterioration in the labor market that is likely to end up in a mild recession. However, by cutting 50 bps when you think the economy is strong, you may be wasting valuable ammunition if your assessment of the economy is right. What if there is a sudden deterioration in the economy or the markets, do we then get a 75 bps cut? Starting with 50 bps without compelling data or forecasts means that you are blunting your interest rate tool. Meanwhile, with a 50 bps cut the Fed is taunting former and possibly next President Trump. This could have serious repercussions next year. The sole dissenter, Michelle Bowman, may just have improved her chance of becoming the next Fed Chair.

Looking ahead, if this was truly a recalibration and 50 has not become the new 25, we still expect 25 bps at each of the three upcoming scheduled meetings in November, December and January. As we have said before, what happens after January will to a large extent depend on the economic policies of the next administration. A Trump victory would likely lead to a universal tariff and a rebound in inflation that should stop the Fed's cutting cycle in its tracks. A Harris victory would likely be less inflationary and give scope for additional rate cuts in 2025. Our forecasts (Table 2) are still based on the assumption of a Trump victory with a universal tariff, but no termination of the Fed's independence. However, if Harris is going to show a sustained lead in the

Electoral College, we may have to alter our assumption about the outcome of the presidential election in November and probably add a number of rate cuts in 2025 and beyond.

Table 2: Rabobank forecasts of target range for federal funds rate in 2024 and 2025

FOMC meeting	*Size of rate change (bps)*	*Target range (%)*
November 6-7	-25	4.50-4.75
December 17-18, 2024	-25	4.25-4.50
January 28-29, 2025	-25	4.00-4.25
March 18-19	0	4.00-4.25
May 6-7	0	4.00-4.25
June 17-18	0	4.00-4.25
July 29-30	0	4.00-4.25
September 16-17	0	4.00-4.25
October 28-29	0	4.00-4.25
December 9-10	0	4.00-4.25

Source: Rabobank

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