INSTANT INSIGHTS

September 18, 2024

Let the Rate Cuts Begin

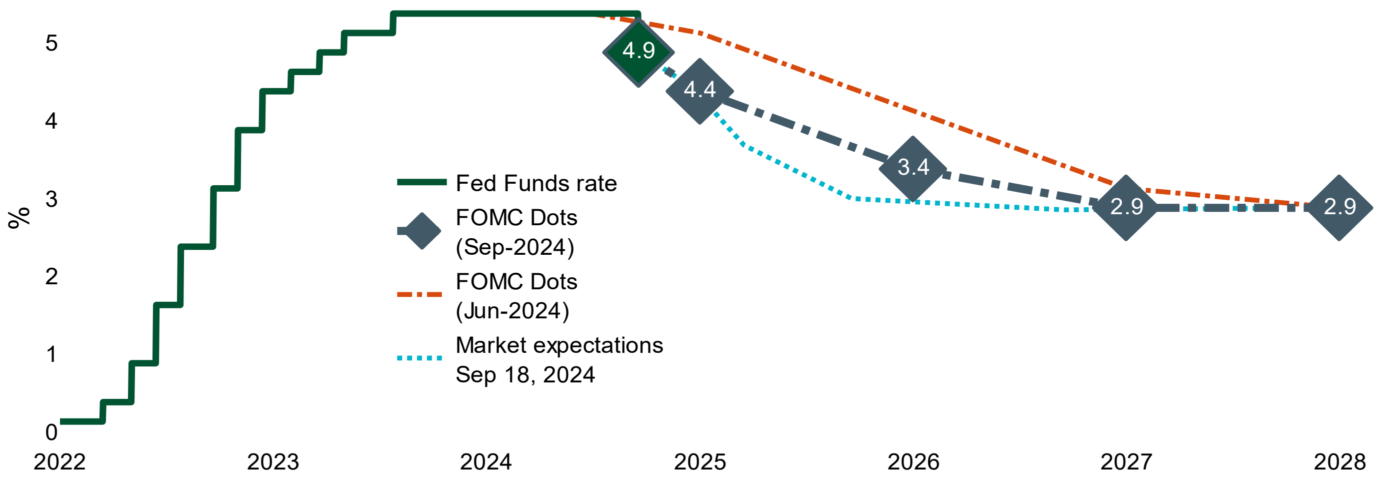
The Federal Open Market Committee (FOMC) cut rates by 50 basis points (bp), taking the federal funds rate to a range of 4.75% to 5%. The committee appeared to shift its focus from inflation to the labor market and penciled in a steeper path of rate cuts to come over the next few years than it did in June. We believe the onset of the cutting cycle may be supportive of fixed income markets.

THE FOMC PROJECTS A STEEPER PACE OF RATE CUTS TO COME

The FOMC forecasts 50bp of further rate cuts into the end of the year, indicating two further 25bp cuts by December. It also implies additional 100bp of cuts to follow in 2025.

Notably, this is still a slower pace than currently priced in by markets (Figure 1). The FOMC also nudged up its median projection of the long-term "neutral" rate, from 2.8% to 2.9%.

FIGURE 1: THE FOMC PROJECTS A STEEPER PATH OF RATE CUTS OVER THE NEXT FEW YEARS THAN IT HAD IN JUNE[1]



Charts are provided for illustrative purposes only.

Additionally, the FOMC updated its quarterly summary of economic projections. It left most of its longer-term median estimates unchanged, but slightly adjusted some of its near-term estimates to reflect slightly slower growth and inflation and higher unemployment.

The Fed trimmed its year-end PCE inflation outlook from 2.6% to 2.3% and its core inflation projection from 2.8% to 2.6%. It raised its near-team unemployment rate projection from 4% to 4.4% for year end-2024.

1 Federal Reserve, Bloomberg, Insight, September 2024

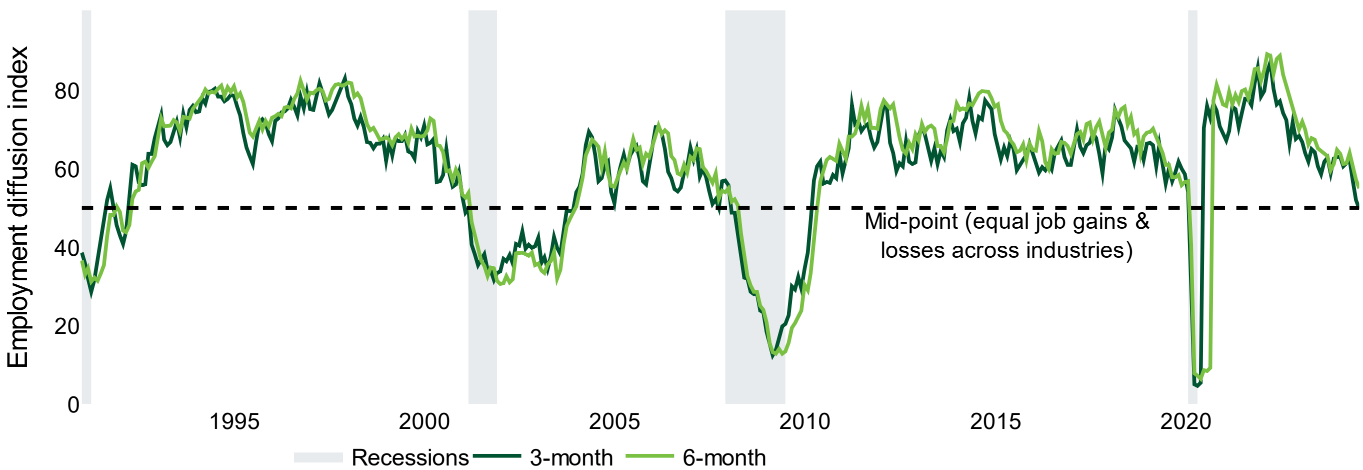
THE FOMC SWITCHES ITS FOCUS FROM INFLATION TO EMPLOYMENT

The FOMC made several changes to its official statement, to reflect its focus shifting from inflation to the labor market. The central bank noted “progress on inflation” and declared the committee now has “gained greater confidence that inflation is moving sustainably toward 2%.” Chair Powell did note that the central bank is “encouraged” but not yet “declaring victory” on inflation.

On the labor market, it changed its characterization of job gains as having “moderated” to “slowed” and added that the committee is “strongly committed to supporting maximum employment.”

When looking at the data holistically, we believe the recent flow of labor market data points to a meaningful slowdown. For example, one measure we track is the Nonfarm Payrolls Diffusion index, which measures the dispersion of employment gains across industries and currently points to a slowdown in the breadth of hiring (Figure 2).

FIGURE 2: EMPLOYMENT DIFFUSION INDICES INDICATE A BALANCE OF JOB LOSSES AND GAINS, HELPING PROMPT THE FED TO ACT [2]



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In our view, cutting 50bp instead of 25bp is indicative of a Fed in a “risk management” mode, seeking to prevent further labor market deterioration to help ensure a “soft landing” for the economy. Chair Powell indicated as much by expressing a willingness to cut faster if “the labor market were to slow unexpectedly.”

MARKETS APPEAR CONFIDENT THAT INFLATION IS SUSTAINABLY MOVING TO 2%

In our view, falling interest rates are likely to entice investors away from cash and into longer-dated fixed income. We expect investors will increasingly look to lock-in yields for longer while they are still available, while also potentially benefiting from price gains as interest rates continue to fall.

2. Bureau of Labor Statistics, NBER, Macrobond, September 2024

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