7 November 2024

Research US

Fed review: In a good place after all

- **The Fed cut rates by 25bp in its November meeting, as widely expected.**
- **Powell delivered practically no new policy signals. Despite the political uncertainty, Powell affirmed that the Fed remains in a good place with cooling inflation and still stable economy.**
- **Market reaction was minimal. Markets price in around 65-70% probability of the Fed delivering another 25bp cut in the December meeting. We make no changes to our call and still expect cuts to continue in every meeting towards H1 2025.**

While all eyes have been on Trump's election win this week, and focus has turned to his expansionary and potentially inflationary fiscal policy plans, the Fed is not yet overly concerned. **Powell made it clear that the election result will not have any near-term policy impact** even if in the longer run, fiscal policies can of course affect the economy. For the time being, as long as we know very little about policy change details, there is simply 'nothing to model'. On a more personal note, when asked if he would resign if requested to do so by Trump, Powell's answer was a very firm 'no'.

In the middle of all the political uncertainty, the Fed remains in a good place. Economy is on a solid footing, inflation continues to cool and labour markets are no longer a source of inflation. Powell noted that incoming data has generally been somewhat stronger than expected in the September meeting and that downside risks have eased, but avoided discussing how this could impact rates outlook for the December meeting and beyond.

Powell emphasized that all options remain on the table going forward, including faster cuts if labour markets weaken unexpectedly, but also slowing down the pace of easing if the Fed estimates it is approaching neutral faster than thought. The Fed is paying close attention to inflation expectations and Powell mentioned he had taken note of the recent uptick in market-based expectations following the election results. That said, the current 5y5y forward rate (2.55%) remains very close to the longer-run target when adjusted for the historical average spread between CPI and PCE inflation measures (0.3-0.4%). In addition, most consumer and business survey-based measures have returned very close to the Fed's target (see chart on the right).

While we agree that the US economy is not in a dire need of easier monetary conditions, we also think the Fed has no reason to delay its return toward neutral any longer. Current ratio of job openings to unemployed job seekers remains below pre-pandemic levels and while layoffs remain low for now, the number has continued to edge higher. When labour markets are on a cooling trend, and forward-looking inflation measures are near target, **the Fed is likely to continue cutting rates at steady 25bp intervals in the coming meetings.**

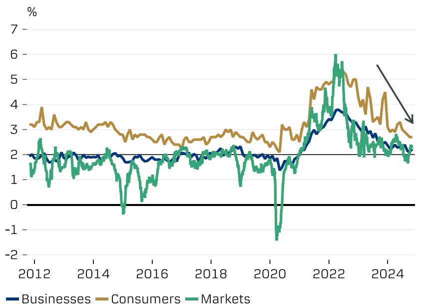
If Trump's policy plans spark a more persistent uptick in inflation expectations, a pause in December could be warranted. In addition, if more expansionary fiscal policies suggest the neutral rate will shift higher, then we think the Fed could end the easing cycle short of our current terminal rate forecast (3.00-3.25%). Markets price in 30-35% probability for a pause in December, but for the time being, **we make no changes to our Fed call.**

Our Fed call summarized (unchanged)

- 25bp cuts in every meeting until June, terminal rate at 3.00-3.25% reached by September 2025.
- QT continues well into 2025

Well anchored inflation expectations allow the Fed to continue cutting rates in the coming meetings.

US 1y Inflation Expectations



Sources: Macrobond Financial, Refinitiv, University of Michigan, Atlanta Fed

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Ad hoc

Date of first publication

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