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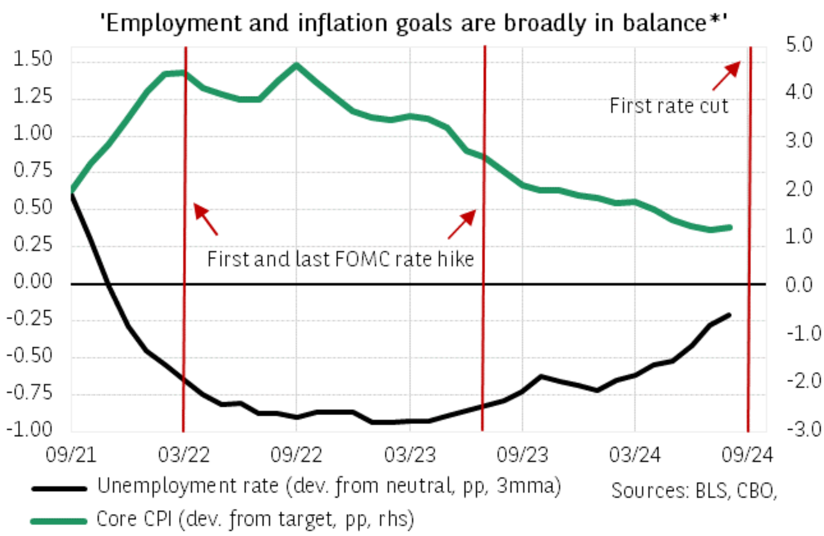
EcoBrief

FOMC: Showing strong commitment to the dual mandate

The September FOMC meeting kick-started the Fed's easing cycle with a significant 50bps cut in the Federal Funds Target Rate, leaving it at +4.75% - +5.0%. Unusually, this large step was taken even as the US economy remains strong, and explicitly with a view to keeping it so.

Effectively, macroeconomic conditions having induced a shift in the Fed's priorities towards the 'maximum employment' component of its dual mandate, while still not declaring mission accomplished on the inflation side. The committee members' projections confirm that more cuts are in the pipeline, but dispersion is large around the median dot showing 50 bps of further cuts by end-2024 and 100 more bps by end 2025, and Fed Chair Powell reaffirmed they will proceed on a meeting by meeting basis, in order to keep the two objectives in balance. This move will bring policy space to EM policy makers and put pressure on the ECB and BOE to possibly pick up the pace – although the latter has decided to hold today -, notably owing to FX implications.

The case for the pivot: recalibration. The easing cycle could be undertaken as a result of easing inflation (CPI at +2.5% y/y as of August, a 3-year low) and softened labour market amid dynamic economic growth. This is explicitly highlighted in the statement which links the rate cut to 'progress on inflation' and the 'balance of risks'. On the other hand, a nominal adjustment appeared necessary in the face of slowing inflation as the latter implied further tightening in real terms with a flat nominal funds rate.



*The language changed from 'continue to move into better balance' between the July and September FOMC meetings.

Preemptive strike: the aggressive 50bp cut, which had been largely priced by markets but defied economists' consensus, did not receive a unanimous vote as a Governor dissented (unseen since 2005). It was prompted by the willingness to act proactively to preserve the strength of the economy, without waiting for the labour market to move from softening to weak territory. The central bank aims to shield the latter from a recessionary deterioration which would call for a 'behind-the-curve' acceleration in the easing course - possibly without completing the return of inflation to target beforehand. Projections regarding unemployment were revised upwards to an annual average of 4.4% in 2024 (up 0.4pp from the Q2 SEP, reflecting the run-up in the rate) and 2025 (+0.2pp).

The decision to recalibrate the monetary stance with the explicit purpose of maintaining a strong economy - the soft landing remains the baseline scenario - is unprecedented. Indeed, recent US monetary history associates jumbo cuts initiating policy easing with times of serious concerns about the economy - the two most recent examples being September 2007 (GFC in the making) and March 2020 (Covid-19). But Chair Powell did a convincing job in the press conference of stressing that the move was not driven by a material concern about the state and the outlook of the economy, and markets accordingly cheered on the move.

No 'mission' accomplished on inflation, in Chair Powell's own words: In order to succeed in managing a soft landing, Powell and the Federal Reserve are required to recalibrate the policy settings in a fashion that supports employment without imperiling the progress made on inflation. In this respect, the rebalancing of risks must not hide the fact that inflation, still described as 'somewhat elevated' in the statement, has not returned to target in a sustainable manner yet, while core CPI still exceeds 3% y/y amid housing inflation stickiness.

Summary of Economic Projections and BNP Paribas scenario: the FOMC anticipates a slower pace in rate cuts in the wake of the jumpstart, with the target rate amounting to 4.4% (mid-point) and 3.4% for, respectively, 2024 and 2025 year-ends. However, FOMC members are highly divided, as 8 out of 19 of them pencil in 25 bps or less of cuts for the remainder of 2024. Besides, Powell reiterated that dot-plots were not 'policy plans' and that decisions would be made following a meeting-by-meeting approach.

We expect the FOMC to implement one additional rate cut (-25bps) by meeting until March 2025 included, before slowing the pace to one quarterly rate cut bringing the target rate to +3.0% - +3.25% at the end 2025. By comparison, market implied rates suggest a further 75bps in 2024 and 125bps in 2025.

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