Paris, 16 September 2024

BNP PARIBAS

La banque d'un monde qui change

EcoBrief

What is at stake for September FOMC Meeting?

We expect September 17-18 FOMC Meeting to result in a 25bps decrease in the Federal Funds Target Rate to 5.0% - 5.25% - barring a huge surprise. This move will launch the beginning of an easing cycle for monetary policy. The combination of improved data and outlook for inflation and the 'unmistakable' softening of the labour market leads to a shift in the Fed's priorities, paving the way for rate cuts. A few thoughts beyond the direction change.

1. The time has come. Powell's language at the Jackson Hole annual symposium was unequivocal. Given that inflation has abated, labour market tensions have dissipated, and the economy remains dynamic, it's time for monetary policy to adjust downwards ;

2. Soft starting. The most likely scenario is that the FOMC starts with a 25bps cut in the target rate. The case for a 50bps cut has lost some ground following the release of the August Employment situation which has not shifted the current narrative towards one of a deterioration prefiguring a recession. If the Fed were to favour a more aggressive -50bps cut instead of a gradual -25bps move, this could illustrate its willingness to be strongly proactive on the employment side of its dual mandate and to take the lagged effects of monetary tightening into account. That said, such a decision could send a negative message that should not be underestimated ;

3. Cutting is a journey, not a destination. How has the neutral rate changed with the economic upheaval of the past few years? The uncertainty surrounding this question underlies that relating to the terminal level at which the policy rate should eventually stand ;

4. Our scenario: by increments. We anticipate the last three FOMC meetings of 2024 (September, November, December) to result in a 25bps rate cut, bringing the Target Rate to 4.5% - 4.75% by year-end. Risks are tilted towards more cuts, with a particular scrutiny over the pace of the non-farm payroll growth and, beyond the unemployment rate developments, the number of layoffs ;

5. Markets: 'More, More, More!' Markets are demanding more easing, as illustrated by the growing 10Y-2Y spread over the past weeks, which came back, slightly, into positive territory after having been inverted since July 2022. Indeed, implied rates suggest a minimum cumulative -100bps for the last three meetings of 2024, with a high (+60%) probability of a -50bps jumbo cut for September ;

6. All Eyes on SEP. Powell should, in line with his Jackson Hole speech, indicate that further decisions will be data dependent. The main hints about the easing pace, as viewed by the Fed, will be provided by the Q3 2024 Summary of Economic Projections, especially through the unemployment rate forecasts and the distribution of projections for the policy rate (dot plots) ;

7. Lagged effects. The undertaking of an easing cycle does not imply a significant loosening of the financial constraints faced by the households in the short run. They will continue renewing mortgages at rates sensibly higher than their pre-tightening standards, unless the 10-year Treasury yield unexpectedly collapses.

Anis Bensaidani
Economist – United States, Japan