

Heading into the FOMC meeting a lot of speculation was generated regarding quantum of rate cut with a bias of 50bps cut flagged by media articles and ex FOMC members speeches. FED being a market friendly central bank aligned with the expectation reduced rate by 50bps, first time since March 2020. This brought the FED fund rate to 4.875% from 5.375%, and kickstarted the US rate cut cycle with a bang. FED stated it will maintain the pace at which it reduces bond holding every month. Powell believes that the FED can reduce the balance sheet and lower rates at same time. The collective message out of Powell's statement, dot plot and summary of projections was that the focus was shifted towards the labour market, with much better balance seen between labour market and inflation. This normalization of policy that has just begun indicates that the US economy is not in recession while the FED is attempting to ensure soft landing.

Our baseline view was that the FOMC will adhere to a gradualist approach during the rate cut cycle and hence the deep 50bps rate cut did surprise us. Going forward, all eyes will remain on Jobs data prints and election outcome before the 7th November FOMC meet.

50bps rate cut by FED; looks to ease monetary policy towards neutral rate

The FED delivered 50bps rate cut that the markets were anticipating despite the economic indicators signalling relatively strong growth momentum. Expectation of a larger move (25 to 50bps cut) have been building over the past week despite core inflation coming slightly higher at 0.3% on MoM basis and the August job report painted a stronger picture than what markets expected. Interestingly there was no data release to move the needle between the start of blackout period and the final decision which shifted the rate cut probability from 25 to 50bps. The trigger was apparently a media article titled ([The FED's rate cut Dilemma: Start Big or Small](#)) in the Wall street Journal and ([Federal Reserve wrestles with how aggressively to cut interest rate](#)) suggesting that the decision is a close call. FOMC members expects the long run neutral rate to be around 2.9% from previously 2.8% a level which has drifted upward as the FED struggles to get inflation back to 2% target implying 100bps cut next year. While Powell stated that the neutral rate is way above pandemic level. From yesterday's statement, it was very clear where the FED's priorities lie as they attempt to attain a fine balance between labor market and inflation dynamic to ensure soft landing in the economy.

FOMC front loads the easing cycle

The FOMC members voted 11-1 in favour for 50bps rate reduction, with the only dissent for 25bps cut, coming from Governor Michelle Bowman, the first Governor to do so since 2005. Meanwhile, the dot plot suggested 9 out of 19 members are expecting 25bps or fewer cuts for rest of the year, indicating that perhaps not all were convinced for bigger rate cut at the start of meeting. The FOMC statement highlights the cooling in the labor market stating that the job gains had slowed. As per August NFP data the economy added 142k jobs while 3 month moving average stayed lower at 116k. The statement hinted the concern about the labor market which has also been the key driver of 50bps cut while stated that the committee is "strongly committed" to support maximum employment in addition to inflation reaching towards 2% target. Powell repeatedly mentioned the labor market as part of his dual mandate.

Summary of Economic Projections indicates unemployment rate to stay higher

The summary of projection suggests that 50bps cut was an effort to front load the removal of policy restriction while additional 50bps cut may not occur at upcoming meeting without a meaningful deterioration in the economy. FOMC members expect further easing in 2025 although at slower pace. The median dot plot for 2025 shifted down to 3.375%. The central bank projected 100bps cut next year 2025 and 50bps cut in 2026 taking the policy rate towards the neutral rate (2.75%-3% range). The FED's new forecast shows it expects the economy to continue to grow at 2% for 2024,2025,2026, while unemployment rate to rise to 4.4% from 4.0% previous projected by end of 2024 and 2025. More importantly FOMC projects core PCE Inflation to descend faster than the June forecast, as the median estimate was revised lower to 2.6% for 2024 and 2.2% for 2025 compared to 2.8% and 2.3% in June. PCE inflation is also expected to ease to 2.3% by end of 2024 and 2.1% by 2025.

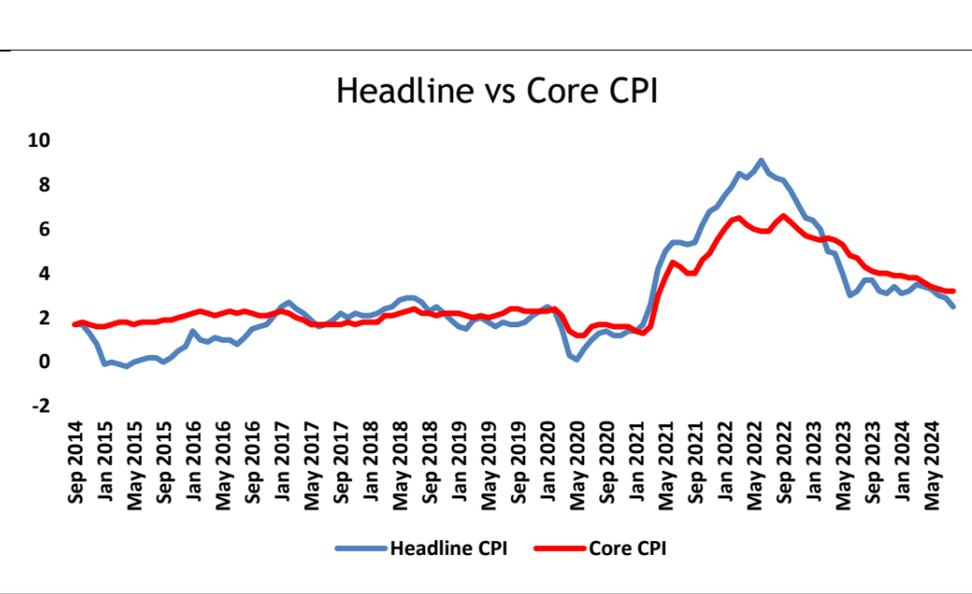
Market Reaction was relatively volatile

Some market volatility was seen during the FOMC rate decision. The 50bps rate cut has led to steepening of curve 10Y/2Y spread c.10bps. The lower end of the curve which track the FED rate closely US2Y touched low of 3.54% and recovered later after the Powell's speech. The DXY pared losses after Powell's speech while made a low of 100.21 level. The other major FX crosses EURUSD, GBPUSD also remained volatile after the announcement.

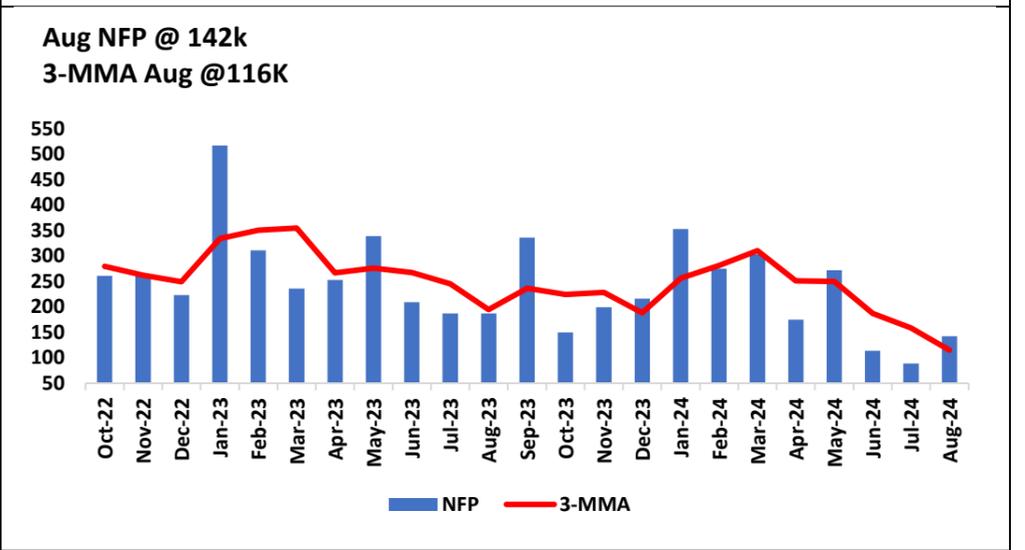
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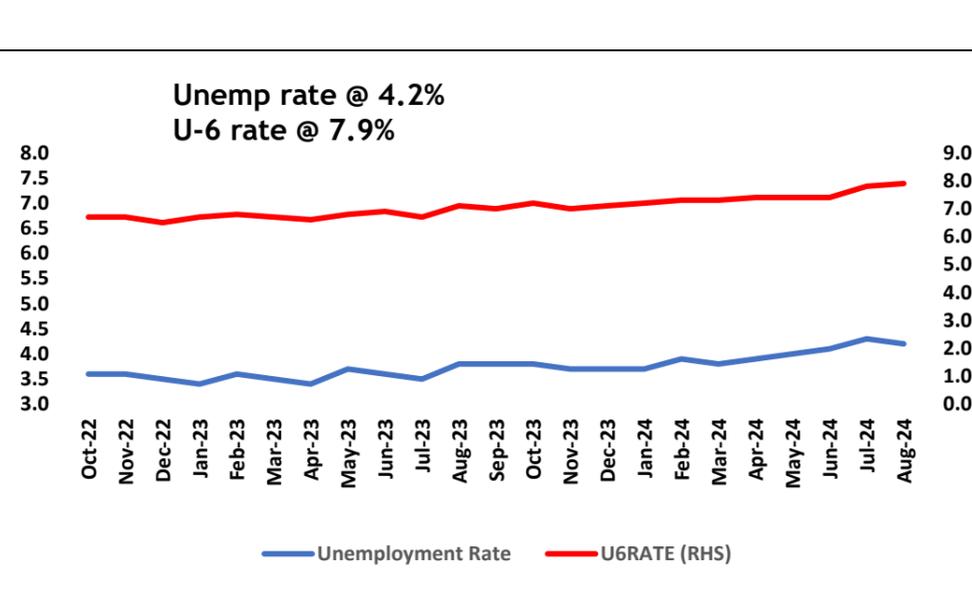
Disinflation trend underway; Aug CPI lowest since Feb 2020 (Fig 1)



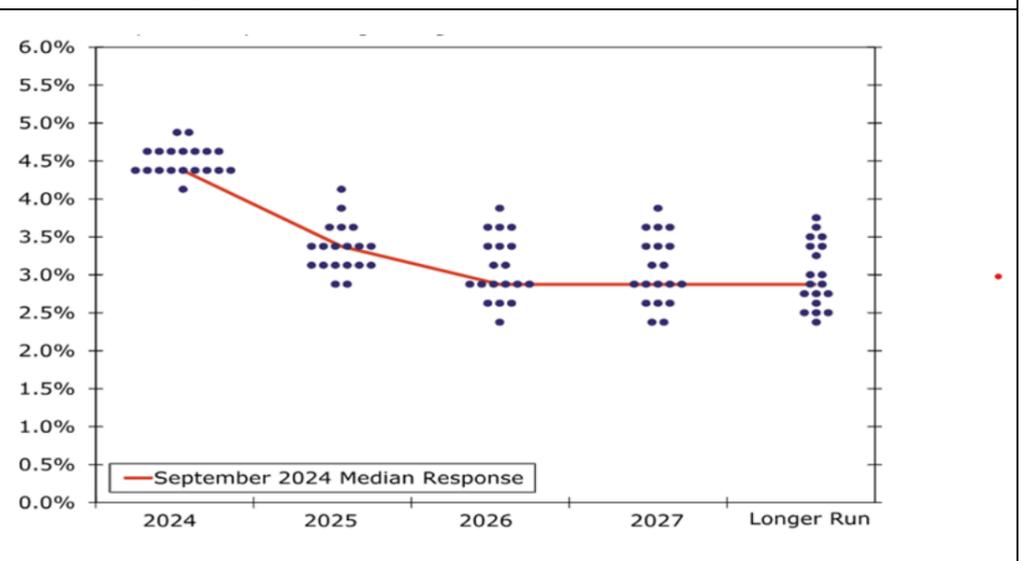
Labor market dynamic under pressure; nonfarm payrolls on weakening trend (Fig 2)



Unemployment rate on uptrend with concern on U-6 rate (Fig 3)



FOMC projects rate cut cycle to continue till 2026 with terminal rate (2.75%-3% range) (Fig 4)



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