With evidence that inflation is coming under control, the Fed can now focus on supporting jobs and growth while curbing the possibility of a recession. (UBS)

Fed starts cycle with a large cut

19 September 2024, 1:20 pm CEST, written by UBS Editorial Team

The Federal Reserve started its rate-cutting cycle with a 50-basis-point reduction, a larger move than adopted by other top central banks. But Jerome Powell, the Fed chair, said the move reflected a determination to "maintain the strength we currently see" in the US economy, rather than fear of an imminent recession.

The decision to kick off monetary easing with a "good strong start," he added, was possible due to greater confidence that inflation was headed sustainably back to the Fed's 2% target.

Ahead of the meeting, markets had been evenly split over whether the Fed would opt for a 50-basis-point cut, or a more cautious 25-basis-point move. US economic data released immediately ahead of the policy decision were more positive, including higher-than expected retail sales for August.

The reaction to the Fed's decision was relatively muted, suggesting investors had focused on Powell's reassurance that the large cut was not due to central bank worries that growth is cooling too abruptly. The S&P 500, which was flat ahead of the meeting, ended the day down 0.3%. The yield on the two-year US Treasury ended the day close to its starting point at 3.62%. The DXY dollar index, which tracks the US currency against six major peers, was also little changed on the day.

What do we expect?

The Federal Reserve has been a latecomer to the global easing cycle. The European Central Bank has already lowered rates twice. There have also been reductions from central banks in Switzerland, Sweden, Canada, New Zealand, and the UK. However, Powell was keen to stress that the Fed had not waited too long, arguing that the US economy remained solid and the labor market strong. Despite an initial 50-basis-point cut, he said, the committee was presently in "no rush" to bring rates down.

Powell's view that the committee did not see an elevated risk of recession was supported by the latest economic projections. The Fed expects the jobless rate to end this year at 4.4%, up from its projection of 4.0% in June, but still low by historical standards. The projections have unemployment staying low at 4.4% by the end of next year. In addition, Fed officials revised their projection for inflation lower, and the median is now for personal consumption expenditure inflation of 2.3% this year, down from the June forecast of 2.6%. For next year, officials forecast inflation to fall to 2.1%, from a June projection of 2.3%.

Officials remained optimistic that inflation would continue to moderate without an abrupt decline in growth. The median forecast was for economic growth to remain solid at 2.0% year over year in the fourth quarter, and at the same pace in each of the following three years.

The dot plot, which charts the rate projections of top Fed officials, implies a further 50 basis points of easing in total for the final two meetings of this year, followed by 100 basis points in 2025. The Fed's view of the economy is in line with our forecast for an economic soft landing. The latest dot plot is also now aligned with our projections for the pace of monetary easing through the end of 2025.

Main contributors: Solita Marcelli, Mark Haefele, Brian Rose, Christopher Swann, Vincent Heaney, Jon Gordon

Original report: **Fed starts cycle with a large cut, 19 September 2024.**