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Special Report: September FOMC Review – "A Commitment Not to Get Behind"

In a move that surprised us, the FOMC lowered the federal funds rate by 50bp and not the 25bp that we had expected. We weren't the only ones surprised. Although the market was split going into the decision – almost exactly 50-50, only nine out of 113 economists surveyed by Bloomberg foresaw the jumbo move that the Fed delivered today.

In our FOMC preview, published this past Tuesday (see here), we pointed out that while we expect only a quarter-point move, a half-point move would make sense – we had argued that the July jobs market data, released two days after the July 31 FOMC would have been sufficient to justify a 25bp reduction then, had the data already been available, meaning today's 50bp cut makes up for the idiosyncrasy of that July meeting.

Furthermore, it's quite clear that the Fed sees the employment side of its mandate as more at risk than the inflation side, declaring that the Committee "had gained greater confidence" on its inflation goals being met, while acknowledging that job gains have "slowed" (a change from merely "moderated" as they said in July).

We should therefore look at Wednesday's move as a preemptive one, explained by Chair Powell in his post-decision press conference that "this recalibration of our policy stance will help maintain the strength of the economy and the labor market…" With inflation threats receding, the Fed made such a strong policy move to react to a weakening jobs market even if several times, Powell declared the labor market to be in "solid condition," and the jumbo cut was a "sign of our commitment not to get behind." Or in other words, to get ahead of an adjusting labor market.

The fact that the September Summary of Economic Projections (SEP) saw an increase in unemployment by end-2024 from the 4% published in June to 4.4% with today's update, above its longer run estimate of 4.2%, is also notable. Clearly, rising unemployment is now the Fed's task to confront with the inflation threat having receded. GDP growth was barely touched, and Core PCE was seen as being lower by the end of 2024.

Exhibit #1: September Summary of Economic Projections

Median Summary of Economic Projections

End of 2024	Mar 24 SEP	Jun 24 SEP	Sep 24 SEP
GDP growth	2.1%	2.1%	2.0%
Unemployment rate	4.0%	4.0%	4.4%
Core PCE	2.6%	2.8%	2.6%
Fed funds rate	4.6%	5.1%	4.4%

Source: BNY Markets, Federal Reserve Board of Governors

Further out in time, the dots saw another 100bp of additional cuts in 2025, and just 50bp more in 2026. This would bring the terminal rate in this cycle to 2.875%, a touch higher than the 2.8% seen in the June SEP. While even the 2025 outlook is murky, if the economy evolves as we – and apparently the Fed – expect, these are reasonable projections, in our mind.

Interestingly, the median dot for rates by the end of this year – with just two meetings left – projects just over two cuts of 25bp each, bringing the funds rate down to 4.375%. We shouldn't read too much into this projection, however, as Powell indicated they could go faster if conditions (read: the labor market) warrant.

The outlook from here is of course "data dependent" and the Fed will address policy on a "meeting by meeting basis." We think that's wise. We (and Powell on Wednesday) have argued that most of the increase in the unemployment rate over the last year or so was due to new entrants into the labor market not finding jobs at the rapid pace they had been in 2023, and not due to firms shedding workers. This is crucial, and key to staving off a worse deterioration in unemployment. While Powell was upbeat about the real economy overall, the jobs market remains concern number one now, supplanting inflation. We could envision deeper and faster cuts in the near future if unemployment rises further.

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Please direct questions or comments to: iFlow@BNY.com

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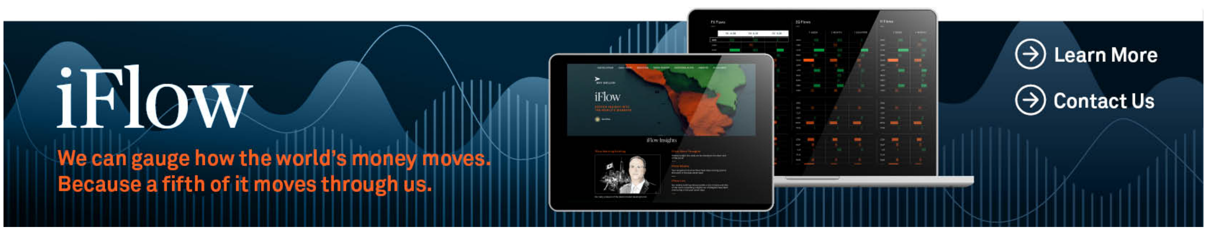

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