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SHORT THOUGHTS

**September 17, 2024**

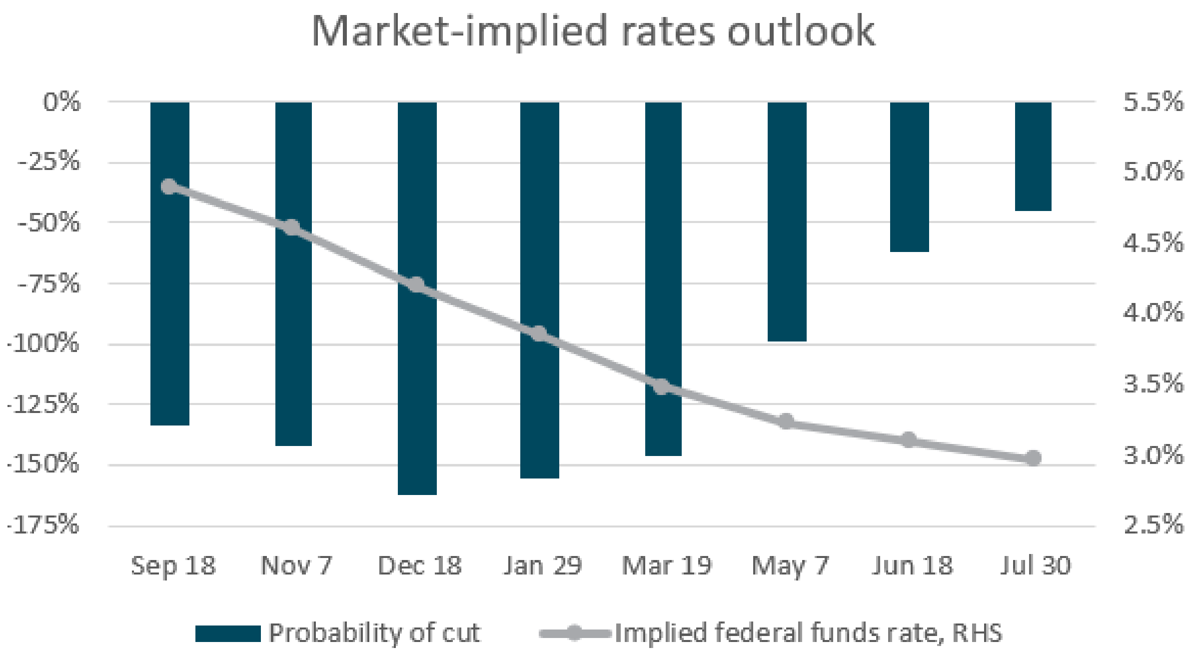
# September FOMC Preview: 50-50 on 25bp or 50bp

- Despite the market being evenly split on the size of the upcoming cut, we think the FOMC will deliver 25bp
- The SEP for year-end 2024 should indicate a total of 75bp of cuts, while 2025 dots will be diffuse
- The dots for economic variables will be weaker, potentially setting up a contradiction between rates and economic outlook

We think that the FOMC will cut rates by 25bp on Wednesday, eschewing a larger 50bp move. While the markets are pricing in a nearly 50-50 chance of a jumbo move, we think the Fed will determine that economic conditions – especially those in the labor market – warrant a more cautious approach as the easing cycle finally commences. In addition to a change in policy rates, the September Summary of Economic Projections (SEP), otherwise known as the dots, will be released, indicating where the Committee thinks rates at the end of 2024, 2025 and 2026 will be, alongside important economic variables like inflation, unemployment and GDP growth. The dots will be at least half of the story Wednesday, in our view.

As mentioned above, as of the end of last Friday, forward market pricing sees a 149% chance of a 25bp cut – meaning a 49% chance of 50bp. Furthermore, pricing further out on the curve envisions a total of 189bp in cuts through the March 19, 2025, meeting. This implies that somewhere along the line between now and then, the Fed will deliver two cuts of 50bp. See Exhibit #1. Also note that the implied funds rate settles in at a terminal rate of around 3%. We don't quibble with that level, but the speed to reach that terminal rate may not ultimately be that which is reflected in the market pricing at present. Right now, the market sees us reaching 3% very quickly – again underscoring the expectation for a few jumbo cuts at some point before March.

**Exhibit #1: Steep Path Priced into Markets**

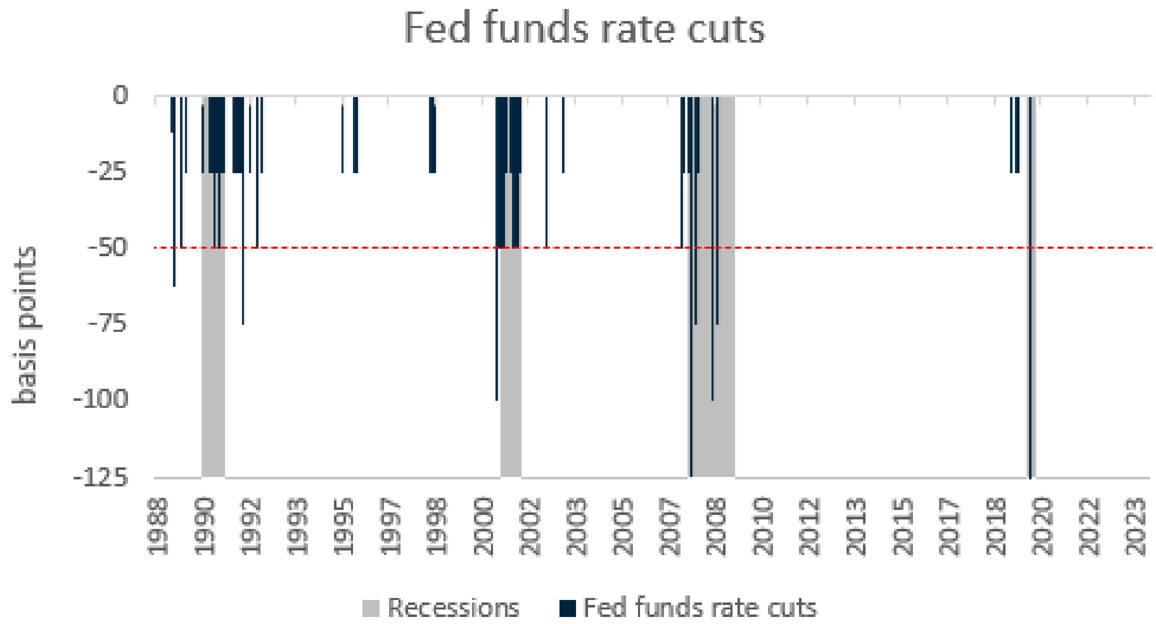



Source: BNY Markets, Bloomberg

So, why do we expect 25bp and not 50? To be frank, we don't think that if the Fed did deliver the larger rate cut it would be a policy mistake. Indeed, if the Committee had seen the weak July jobs data (published on August 2) at their July 31 meeting, they probably would have cut rates at that time. So, one could argue that a "catch up" move of 50bp is defensible. However, the August jobs report – released a month later – was much more comforting than July's and probably gives the Fed cover to move by just 25bp. Furthermore, additional data on the job market, such as initial unemployment claims, have been relatively benign.

The Fed rarely moves by 50bp unless the economy is already in recession – and we don't think this is the case – or if a deeper financial crisis is brewing, which is obviously not a current concern. Exhibit #2 shows every FOMC rate cut since 1988, and while 50bp moves are not rare, they typically occur when one or both of these conditions are met.

**Exhibit #2: History of Fed Rate Cuts**




Source: BNY Markets, Federal Reserve Board of Governors

What does a potential 25bp cut mean for the dots, then? In that case we expect the median projection for the federal funds rate will show three cuts of 25bp by the end of the year, down to around 4.75%. If they were to go lower than that, it would signal that at least one of the last meetings of the year would feature a jumbo cut. If that were true, then why not start with 50bp on Wednesday? This would represent an incompatibility of the dots with an initial 25bp cut. So, instead we expect the more cautious path being indicated. This outcome would likely be seen as hawkish and could give the markets some pause.

As for the 2025 SEP for the funds rate, we will be keen learn how the Committee expects the easing cycle to evolve. The outlook in the short term is already murky, as we intimated above. For next year, it's even more uncertain. The election, the speed of labor market adjustment, how well aggregate demand will hold up, and how close inflation gets to the Fed's target are all sources of uncertainty. Reasonable assumptions could lead to very divergent forecasts. The 2025 dots released this past June ranged from 5.5% (no change in rates at all!) to below 3%. That range will almost certainly be narrower this time around, but where it settles – especially relative to market expectations, will show a lot concerning how the Fed feels about those variables.

Regarding these macroeconomic variables themselves, we note that the June SEP was relatively upbeat (see Exhibit #3), with median projections for GDP growth and unemployment by end-2025 at 2.1% and 4.0%, respectively. We expect these to change materially, with GDP growth lower and unemployment – which is already at 4.2% – higher.

How much these projections are revised lower will be interesting reading and may provide some inconsistency with the dots for the federal funds rate. If the latter only reflect three total cuts for the rest of this year, but the real economy variables are revised lower, how do those two incompatible results hold together? This is why we think the dots will generate significant scrutiny.

In summary, we expect a 25bp cut – although we acknowledge that 50bp is not inconceivable. We think the Fed will start off the easing cycle gradually, even though as we said above, we think a 50bp cut could be warranted. The Fed moves cautiously unless it absolutely has to, so the smaller option seems right to us. After the size of the rate cut, the dots and their internal consistency will be the focus of attention for the most important FOMC meeting of the year.

**Exhibit #3: Recent SEP and Our Expectation for September 18**

| | Mar 23 SEP | Jun 23 SEP | Expectation |
|---|---|---|---|
| GDP growth | 2.1% | 2.1% | *Lower* |
| Unemployment rate | 4.0% | 4.0% | *Higher* |
| Core PCE | 2.6% | 2.8% | *About the same* |
| Fed funds rate | 4.6% | 5.1% | *~4.75%* |

Source: BNY Markets, Federal Reserve Board of Governors

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

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