ECONOMIC UPDATE

REGIONS

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September FOMC Meeting: A Bigger First Step On The Path To Neutral

- The FOMC lowered the Fed funds rate target range by fifty basis points, putting the mid-point of the target range at 4.875 percent
- The updated dot plot implies 200 basis points of funds rate cuts (cumulative) by year-end 2025, compared to 125 basis points in the June edition

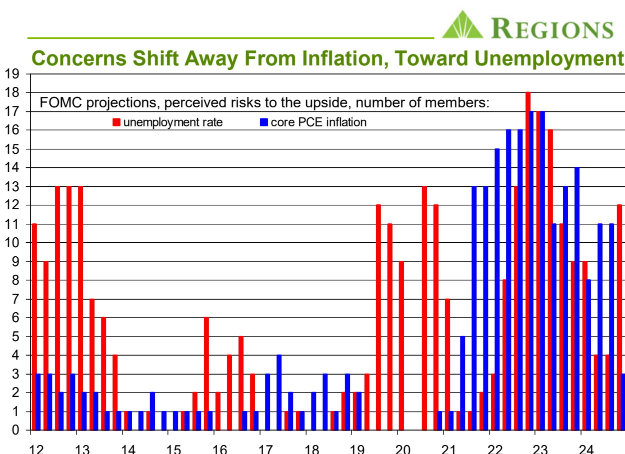
The FOMC cut the Fed funds rate target range by fifty basis points as this week's meeting, lowering the mid-point of the target range to 4.875 percent from the previous mid-point of 5.375 percent. Ahead of this week's meeting, there was no doubt that the Committee would lower the funds rate target (range), instead, the uncertainty was around whether the initial cut would be twenty-five or fifty basis points. That they opted for the larger cut can be seen as prudent risk management; to the extent there has been considerable deceleration in inflation and they perceive the downside risks to the labor market as having increased, the larger cut can be seen as a more prudent move, though implicit in this move is that the FOMC sees little risk that it will rekindle inflation pressures. Ahead of the meeting, we had seen the choice between twenty-five and fifty basis points as pretty much of a toss-up and noted that we thought the more important point would be where the updated dot plot implied the funds rate would ultimately land. Keep in mind that the prior (June) edition of the dot plot reflected renewed concerns over inflation, that those concerns have subsequently abated is reflected in the updated dot plot. There was one dissent, cast by Governor Bowman, to today's vote for a fifty basis point cut in the funds rate, making this the first dissent by a member of the Board of Governors since 2005.

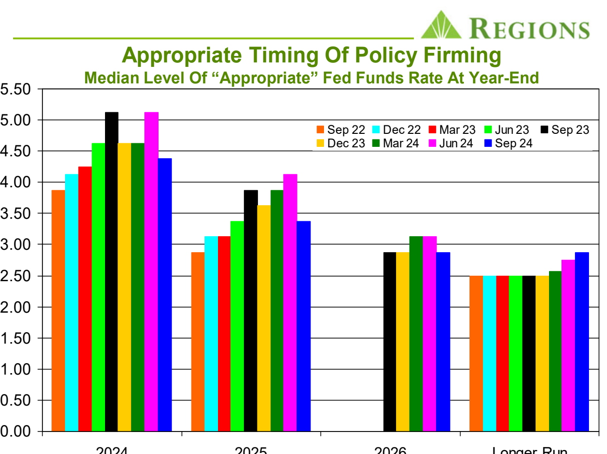
The post-meeting policy statement notes that the economy has continued to expand "at a solid pace." One key difference from the July edition, however, is the passage stating that "the Committee has gained greater confidence that inflation is moving sustainably toward two percent, and judges that the risks to achieving its employment and inflation goals are roughly in balance" – the July statement noted that the risks continued to move into "better balance." Another notable difference is that the July passage noting the Committee was strongly committed to returning inflation to its two percent target now reads "the Committee is strongly committed to supporting maximum employment and returning inflation to its two percent objective."

The updated economic forecasts put expected real GDP growth, on a Q4/Q4 basis, at 2.0 percent in 2024, down from 2.1 percent in the June projections, while keeping it at 2.0 percent in both 2025 and 2026 (Q4/Q4). The updated forecasts show a higher Q4 average unemployment rate in 2024 than the prior edition – now 4.4 percent rather than 4.0 percent – in keeping with the increase in the jobless rate over the past few months. The updated forecasts show lower rates of headline and core PCE inflation relative to the June forecasts. It is also worth noting that Committee members' assessments of the risks to their forecasts of inflation and the unemployment rate have shifted meaningfully. Twelve members see the risks to their forecast of the unemployment rate as being weighted to the upside, up from four members in the June forecasts, while only three members saw the risks to their forecast of core PCE inflation as weighted to the upside, down from eleven in the June forecasts and the fewest in any edition of the forecasts since December 2020. This is another manifestation of the Committee seeing the risks to the two sides of their dual mandate as being in closer balance than has been the case for some time.

The updated dot plot implies an additional fifty basis points of funds rate cuts by year-end 2024 followed by one hundred basis points of cuts in 2025. Recall the June dot plot implied only a single twenty-five basis point funds rate cut in 2024. Chair Powell noted in his post-meeting press conference that each of the nineteen FOMC members projected multiple funds rate cuts over the forecast horizon, something notably absent from prior editions. The median estimate of the "neutral" Fed funds rate edged up to 2.875 percent, but the dot plot implies the funds rate won't fall back to neutral until some point in 2026. Again, though, assessments of the appropriate path of the funds rate will change along with the economic outlook. It is important to note that runs both ways; Chair Powell stated that, should there be signs of mounting inflation pressures, the Committee can "dial back policy restraint more slowly" than implied by the dot plot.

Though stressing that the risks to the two sides of the dual mandate have come into better balance, Chair Powell noted that the direction of change in the labor market is something the FOMC is focused on. At the same time, however, Chair Powell cautioned against seeing fifty-basis point cuts as a new normal; whether or not market participants heed this caution, however, remains to be seen.





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