

MARKET SIGHT LINES



The Federal Reserve Signals a Slower Rate Cut Cycle

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Recent data shows that inflation has firmed and seems to have settled above the Federal Reserve's (Fed's) 2% inflation target. Even so, the Fed cut rates another 0.25% at its final meeting of 2024, leaving monetary policy still restrictive to fight inflation. Investors remain appropriately focused on the Fed's expected policy in 2025, and officials now signal fewer rate cuts. In this Sight|Lines, we review inflation, Fed policy actions, and the economic and market implications of this modest policy shift.

THE TAKEAWAY: THE FED CONFIRMS HIGHER RATES FOR *EVEN LONGER*

Sticky inflation remains above the Fed's 2% target. At its December meeting, the Fed cut rates a quarter point but signaled a slower pace of rate cuts next year. In summary:

- Popular inflation measures show inflation remains above the Fed's 2% target.
- Market participants still expect inflation above the Fed's target over the next year.
- The Fed cut its funds rate 0.25% at its December meeting.
- The Fed issued its latest Summary of Economic Projections (SEP), offering data on Fed officials' future views on inflation, the funds rate, and GDP, signaling the median view to be a positive economic environment, sustained inflation, and fewer rate cuts.
- Fed funds futures now forecast just 0.25% in cuts in 2025.
- In his post-meeting press conference, Fed Chair Jerome Powell implied that Fed officials debated the rate cut, considering no action.
- Powell also reinforced his positive view that the Fed has made very good progress on inflation over the last couple of years, but there's more to do.
- Market interest rates moved higher after the Fed meeting and are expected to remain higher going forward.
- Stocks moved lower after the Fed meeting and Powell press conference.
- This all means a higher cost of debt for individuals, businesses, and our government.

IN-DEPTH: THE FED CUT RATES A QUARTER OF A POINT BUT SIGNALLED A SLOWER PACE IN CUTS GOING FORWARD AND HIGHER RATES FOR *EVEN LONGER*

Even with inflation remaining above the Fed's 2% target, the Fed cut rates a quarter point at its December meeting but signaled a slower pace of cuts next year. Going deeper:

- Core inflation measures, which exclude food and energy, have been above the Fed's 2% target:
 - The core consumer price index averaged an annualized rate of 2.85% over the last six months.
 - The core producer price index averaged an annualized rate of 3.40% over that period.
- Market participants still expect inflation above the Fed's target over the next year:
 - The one-year breakeven rate, market expectations for average inflation, sits at 2.58%.
- The Fed cut the funds rate at its December meeting:
 - The funds rate range now sits at 4.25%-4.50%, down 0.25%.
 - Fed officials explained the rate cut is justified given a looser job market.
- The Fed issued its latest Summary of Economic Projections (SEP), offering its officials' future views:
 - Core PCE inflation is projected to be 2.5%, based on the median projection from officials.
 - The median funds rate projection is 3.9%, reflecting cuts of 0.5% from here.
 - The median GDP growth rate is now at 2.1%, equal to the long-term level of trend growth.
- Fed funds futures imply the potential for fewer cuts next year, compared to the Fed's projections:
 - These futures indicate investors are expecting just one 0.25% in cut in 2025, compared to the Fed's projection of two.
- In his press conference, Powell implied that officials debated the rate cut, considering no action:
 - "... today was a closer call, but we decided it was the right call because we thought it was the best decision to foster achievement of both of our goals, maximum employment and price stability."
- Market interest rates jumped after the Fed meeting:
 - The 10-year yield rose to 4.52%, and forward rates signal investors still expect this benchmark rate to remain between ~4% and ~5% over the next 20 years.
 - This continues to mean a higher cost of debt for individuals, businesses, and our government.
- Stocks moved lower after the Fed meeting and Powell's press conference:
 - The S&P 500 fell 2.95% for the day, and the Nasdaq fell 3.56%.

CONCLUSION

Recent data shows inflation has settled above the Fed's 2% inflation target, and even so, the Fed cut rates another 0.25% at its final meeting of 2024. Even with this cut, monetary policy remains restrictive to fight inflation going forward. In fact, Fed officials now project fewer cuts next year. Understanding these results is helpful as we evaluate Fed policy possibilities in the new year.

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