

FEDERAL RESERVE BANK

Special Coverage:

FOMC signals easing cycle could begin soon

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Special Coverage:

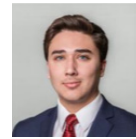
FOMC signals easing cycle could begin soon

Key takeaways

- ◆ As expected, the FOMC kept rates unchanged at the July meeting. The Fed funds rate remains in the 5.25-5.5% range. We expect the FOMC to begin the monetary policy easing cycle in September by cutting the Fed funds rate 0.25% to a range of 5-5.25%. In 2025, we expect the FOMC to cut rates three times, leaving the Fed funds rate at 4.25-4.5%.
- ◆ The US economy is slowing but growth remains above-trend. Labour markets are cooling as the unemployment rate is drifting higher. Financial markets have shifted of late, reflecting the weakening economy and the better inflation data. The



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assumption is that the odds of the onset of a Fed monetary policy easing are higher. In addition, small-cap equities have rallied with the increased odds of lower interest rates.

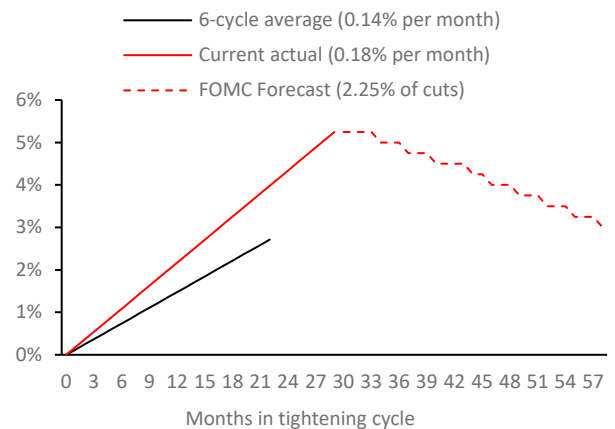
- ◆ In the short term, equity markets will see some continued two-way rotation between sectors and the value and growth styles as they weigh the run-up in valuations, the economy, and the impact of the expected rate cuts. Longer term, continued disinflation, lower interest rates, and strong profit growth (in spite of the slowing economy) will provide a solid backdrop for US equities. We maintain our US equity overweight and our balanced sector stance. Fixed income investors should continue to look for lower policy and market rates, and keep an eye on quality and investment grade as the business cycle slows and balance sheets feel the stress.

What happened?

- As expected, the FOMC kept the Fed funds rate unchanged in the 5.25-5.5% range at its July meeting. We expect the FOMC to begin the monetary policy easing cycle in September by cutting the Fed funds rate 0.25% to 5-5.25%. In 2025, we expect the FOMC to cut rates three times, leaving the Fed funds rate at 4.25-4.5%.
- There were only a few changes to the statement this time, but they were dovish in nature, leaving the door open to a possible rate cut in September.
- Fed Chair Jerome Powell stated, “We’re maintaining our restrictive stance of monetary policy in order to keep demand in line with supply and reduce inflationary pressures.” -- indicating that the Fed needs to see further disinflation to ease.
- Second-quarter inflation readings were heading back toward the 2% target. However, the Fed doesn’t want markets to fully price in rate cuts now as Powell said, “We’ve made no decisions about future meetings and that includes the September meeting.”

- US growth has been easing, but the move from very strong to more normal growth rates is healthy. The 2Q24 growth was +2.8% and consumer spending was 2.3%.
- Labor markets are cooling as the unemployment rate is drifting higher. The unemployment rate has risen to 4.1% in June but remains near 60-year lows. Payroll employment rose +177,000 in the last three months vs 267,000 in the first three months of the year.
- In June, the US PCE deflator pierced the Fed's 2% symmetric target range of 1.5-2.5%. Powell has often said that the FOMC wants to see inflation "on a clear path" towards 2%. Wages have slowed to 3.9% from a peak of 5.9% in 2022.

Will the most aggressive Fed tightening cycle ever result in aggressive easing as well?



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 31 July 2024.

Investment implications

- Financial markets have shifted of late, reflecting the weakening economy and the better inflation data. The assumption is that the odds of the onset of a Fed monetary policy easing are higher. In addition, small-cap equities have rallied with the increased odds of lower interest rates.
- Historically, Fed easing cycles have helped lower the cost of capital, which has been a positive factor for markets, especially in the US.
- We believe that in the short term, equity markets will see some continued two-way rotation between sectors and the value and growth styles as they weigh the run-up in valuations, the economy, and the impact of the expected rate cuts. Longer term, continued disinflation, lower interest rates, and strong profit growth (in spite of the slowing economy) will provide a solid backdrop for US equities.
- It remains an earnings-driven equity market. S&P 500 earnings are forecast to rise 10.9% in 2024 and 14.8% in 2025. Lower rates should help boost M&A and investment activity. Therefore, we maintain our US equity overweight and our balanced sector stance.
- Fixed income investors should continue to look for lower policy and market rates. They should also keep an eye on quality and investment grade as the business cycle slows and balanced sheets feel the stress. We continue to put our cash to work in bonds and multi-asset strategies.
- US economic resilience, relatively high yields, monetary easing elsewhere, and sometimes underwhelming activity data outside of the US can still contribute to a firm USD, particularly with so much Fed easing already assumed.

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