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Economic Research

Economic Briefing

Fed delivers a hawkish rate cut

The Federal Reserve cut its key interest rates by 25 basis points today, as expected, the third interest rate cut in a row. However, the Fed indicated a slower pace for the future, and the updated projections of the meeting participants show only two instead of four rate cuts for next year.

Fed cut rates by 25 basis points...

At its meeting today, the Federal Reserve decided to cut interest rates by a further 25 basis points, bringing the target range for the federal funds rate down to 4.25% - 4.50%. With this third interest rate cut in a row, the Fed has reduced the key interest rate by a total of 100 basis points. Beth Hammack, President of the Cleveland Fed, voted against the cut. Greater dissatisfaction with the decision was evident among the seven non-voting members, of whom as many as three preferred unchanged rates (according to the updated dot plot published today).

The **statement** released after the meeting contained an interesting adjustment: the decision on the “extent and timing” of further adjustments would take into account the data, the evolving outlook and the balance of risks. Previously, the Fed had only talked about further adjustments. This suggests that the Fed is no longer likely to cut key rates at every future meeting.

... and indicates only two more cuts for next year

The updated projections of the meeting participants suggest that only 50 basis points of further interest rate cuts are still on the cards for 2025. According to the dot plot, the meeting participants’ assessment of the appropriate interest rate path, the average key interest rate at the end of next year is expected to be 3.9%. In September, the assumption was 3.4% (the dot plot shows the mid-point of the target range rounded to one decimal place, see chart). Thus, the Fed has taken two of the four rate cuts previously projected for 2025 off the table.

The biggest change in the projections concerns inflation: the meeting participants expect only a slight decline in inflation next year: After 2.8% in Q4.2024, inflation is expected to rise to 2.5% (September projection: 2.1%). The core rate should then also be 2.5% (previously: 2.2%). Inflation is not expected to reach the target of 2% until 2027 (previously: 2026).

There is likely to be a pause

18 December 2024

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In the press conference following the meeting, Powell pointed out that monetary policy was significantly less restrictive after interest rate cuts of 100 basis points in total and that the pace of adjustments could therefore be slowed. He said that the Fed was “at or near the point” where such a change in pace was appropriate; this is also the reason for adding the word “timing” to the statement. This is also because interest rates are closer to the neutral level, which neither boosts nor slows down the economy.

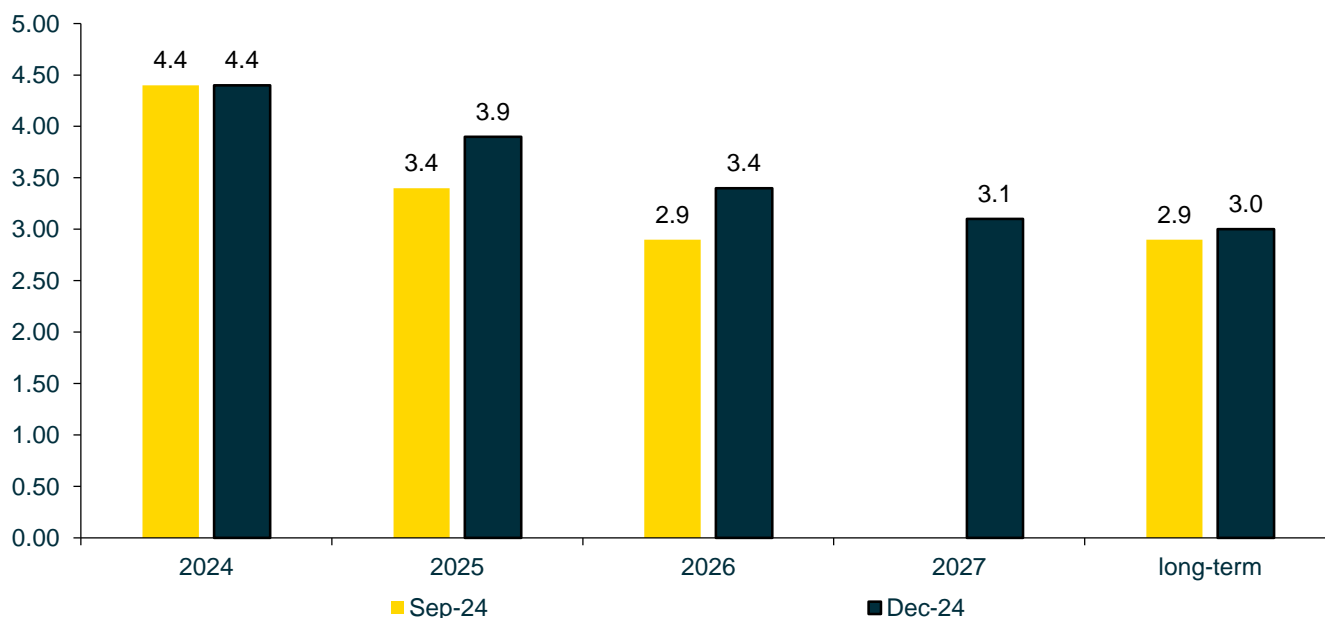
Powell was very optimistic about the US economy and pointed out how well it is doing by international standards. Further rate cuts would require progress on inflation. Overall, Powell still sees the “story” of a gradual slowdown in inflation as intact, but also hinted that the decline in inflation was slower than previously expected. The fact that interest rates were lowered at all today against this backdrop is apparently mainly due to the labor market. There is some concern about a further slowdown here, which would be undesirable.

Some of the meeting participants also referred to the higher uncertainty in their projections, which is due to the possible tariff increases and other measures of the future US government. This could also suggest a more cautious approach by the Fed.

All in all, there is some evidence that the Fed will remain on hold at the next meeting in January. The Fed is now in a new phase and will proceed cautiously, Powell said. There were likely already lively discussions at this meeting as to whether a further cut today would be appropriate. In any case, the central bankers now expect a slower decline in inflation. Accordingly, they expect a shallower decline in interest rates. The Fed has thus concurred with our forecast that there will be only two interest rate cuts in 2025.

Chart 1 - Fed members now pencil in only two rate cuts for 2025

Median projection of Fed Board members and Fed Presidents of appropriate policy path, midpoint of target range at year-end in %



Source: Fed, Commerzbank Research



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