18 December 2024

Research US

Fed review: In a new phase

- **The Fed cut the policy rate target range by 25bp to 4.25-4.50%, as expected. The ON RRP rate was cut by an additional 5bp, as discussed in November minutes.**
- **Powell delivered a clearly hawkish message, highlighting that the easing cycle has entered a 'new phase' and that barring major downside surprises in data, the Fed is looking to slow down the pace of rate cuts starting from January.**
- **We revise up our forecast for the Fed funds rate, and now expect only quarterly 25bp rate cuts from March 2025 onwards. We maintain our terminal rate forecast at 3.00-3.25% unchanged (reached in March 2026, prev. September 2025).**
- **Markets' financial conditions tightened sharply after the decision and the move continued during the press conference. UST yields moved up by more than 10bp across the curve, and EUR/USD fell by more than a figure to below 1.04.**

Powell stated that the Fed's easing cycle is now entering a 'new phase' after the central bank has reduced rates by a total of 100bp within three months. Barring major downside surprises in the December Jobs Report and CPI, the Fed is looking to slow down the pace of rate cuts by holding rates steady in January.

The statement included a new reference to the FOMC considering not only **the extent** but also **the timing** of rate cuts going forward. Median 2025 inflation projections were revised up to 2.5% on headline basis (from 2.1%) and 2.5% on core basis (from 2.2%). The updated median dots now project only a single 25bp cut every six months for the next 2.5 years. Longer-term terminal rate assumption was little changed (3.0%; from 2.9%), but the participants expect to reach the said level significantly later than previously.

Powell was not overly concerned with realized data, which still shows both price pressures and labour market conditions on generally cooling trends. Rather, the change in the outlook was motivated by a significant shift in the risk perception. **15 out of 19 respondents saw core inflation risks weighed to the upside (prev. 3 out of 19)**, while risks to GDP growth and unemployment rate had become better balanced. Powell admitted that some participants had included preliminary conditional estimates of coming fiscal and trade policies into their updated projections.

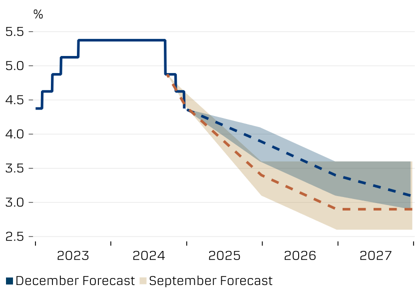
Markets now price in less than 2bp worth of cuts for the January meeting (approx. 5% probability). While we think the risk of a meaningful downside surprise in data is larger than that, **we still revise up our forecast for the Fed Funds rate. We no longer expect a cut in January, but rather see the next reduction in March, followed by quarterly cuts at the meetings associated with updated economic projections**. We maintain our terminal rate forecast unchanged at 3.00-3.25% but now expect the Fed to reach it only by March 2026 (prev. Sep 2025). The level remains well below market expectations.

The Fed also delivered an additional 5bp reduction to the ON RRP rate, as discussed in the November minutes. The move will not have a meaningful impact on the overall policy stance, but it underscores the Fed's cautious approach to quantitative tightening. That said, we still think the Fed will continue doing QT until the second half of 2025.

Our updated Fed call

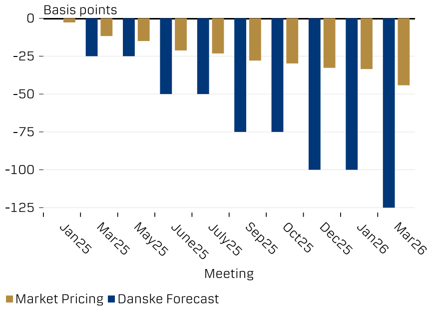
- The next 25bp rate cut in March 2025, followed by quarterly reductions until March 2026. Terminal rate forecast of 3.00-3.25% unchanged.
- QT continues until H2 2025

Chart 1: FOMC projects a much slower rate cutting cycle than before



Sources: Macrobond Financial, The Fed

Chart 2: We still expect the Fed to cut by significantly more than markets



Sources: LSEG, Danske Bank

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