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Economic Research

Economic Briefing

Fed delivers the expected 25 bp cut

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As expected, the Federal Reserve cut its key interest rate by 25 basis points at its meeting today. It thus returned to its more customary pace after having moved by 50 basis points in September. The central bank does not want to see any further weakening of the labor market and continues to expect that inflation will sustainably fall to the 2% target. Accordingly, the Fed is likely to cut interest rates further at the next few meetings.

Fed cut target rate by 25 basis points

The Federal Reserve cut its key interest rate by 25 basis points today, with the target range for the Fed Funds falling to 4.50% - 4.75%. Today's decision was unanimous, after Governor Bowman voted against a large 50 basis point rate cut at the last meeting.

The Fed's post-meeting statement was only marginally adjusted. As before, the Fed notes that further rate cuts depend on incoming data, the evolving outlook, and the balance of risks. Apparently, the data released since the last meeting have done little to change the outlook.

Press conference

Fed Chairman Powell again noted that the Fed has made considerable progress towards its goals over the past two years. Now, he said, the focus is on recalibrating monetary policy; a significantly restrictive stance is no longer necessary. The further cooling of the labor market – the labor market is now less tight than in 2019, just before the coronavirus crisis – suggests that interest rates should be lowered towards the neutral level (Chart 1). According to Powell, the labor market no longer poses any inflation risks. However, there is no need to rush when it comes to interest rate cuts, “nothing in the data” suggests this. As soon as the neutral level, which is not known precisely anyway, is approached, the Fed could proceed more slowly. By this, Powell apparently means that the Fed may cut rates no longer at every meeting.

With regard to possible significant changes in fiscal policy that could have an impact on the economy and thus also on monetary policy decisions, Powell said that this would not affect the Fed in the short term. After all, no details are yet known that would then be incorporated into inflation and growth forecasts. Otherwise, Powell refused to make any political statements, including on possible risks to the Fed's independence in the wake of Donald Trump's election victory.

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Powell admitted that there is currently a considerable degree of uncertainty. In this unclear environment, he does not consider forward guidance to be appropriate. This is an interesting argument, because forward guidance is actually supposed to reduce uncertainty. He repeated the phrase that the Fed makes its decisions from meeting to meeting.

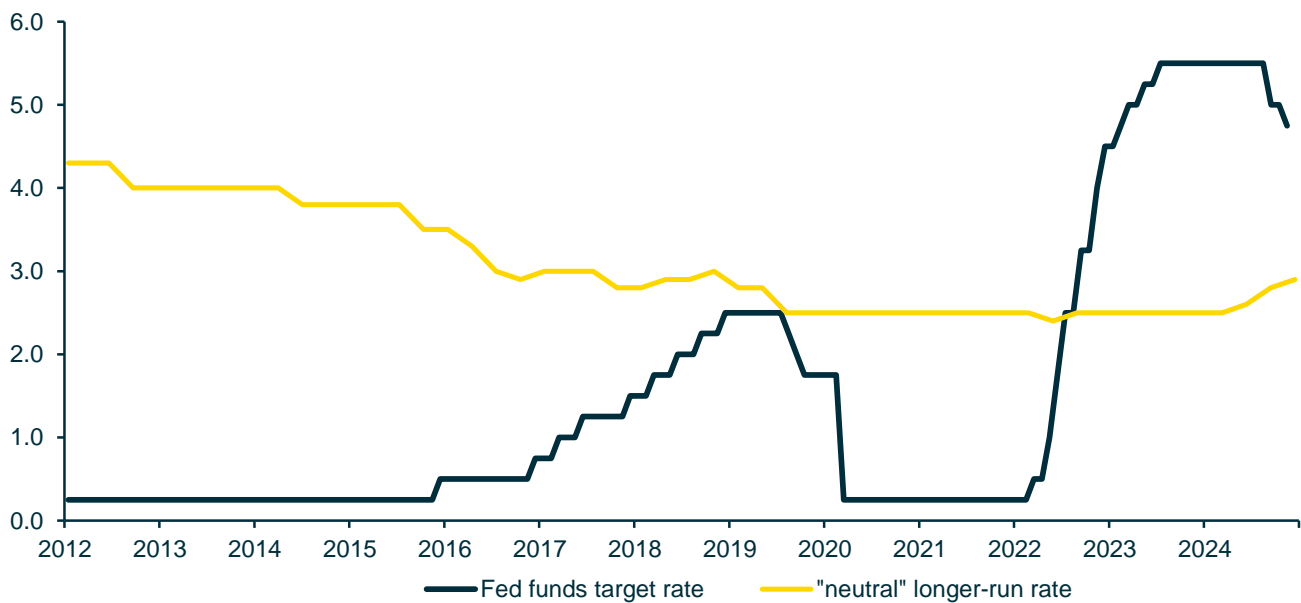
Our assesment

In the context of the US elections, the Fed was obviously – and unsurprisingly – very careful not to cause additional unrest. After starting the rate-cutting process with a big step, it is now falling back into its usual 25 bp pace. After all, larger steps usually indicate that the Fed has adjusted its course too late or that there is even an emergency and that monetary policy needs to be changed quickly. In view of the data, there is no reason for this.

We expect the Fed to remain on a rate-cutting path for the time being. A further step at the last meeting of the year in December is very likely from today’s perspective. The Fed will probably cut rates further at the beginning of the year as well. However, we now expect the interest rate cut cycle to end at 4.00% (and not, as previously expected, at 3.50%). This leaves only three steps of 25 bp each. We have adjusted our forecast accordingly. Further easing seems unlikely in view of the presumably inflationary policy of the future president, Donald Trump.

Chart 1 - The Fed is slowly moving towards a "neutral" level for the fed funds

Fed funds target rate (upper bound of target range) and median estimate of FOMC meeting participants of appropriate longer-run rate



Source: Fed, Commerzbank Research



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