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Situation analysis

November 7, 2024

# Fed continues path to normal with 0.25% interest rate cut

## Key takeaways

- The U.S. Federal Reserve (Fed) cut interest rates by 0.25% to a range of 4.50%-4.75% to gradually normalize policy as inflationary pressures ease.
- The Fed's rate cut today continued its trajectory of lower policy rates after a 0.50% reduction at its previous meeting.
- Chairman Jerome Powell set the stage for additional rate cuts in coming months, referring to the economy as strong and noting progress on slowing inflation.

The Federal Reserve cut its target federal funds interest rate by 0.25% to a target range of 4.50% to 4.75% following its regularly scheduled two-day meeting. Economists and investors anticipated the incremental shift lower in rates after last meeting's 0.50% reduction, with interest rate markets pricing in 0.75% to 1.00% of additional rate cuts by the end of 2025. Stronger economic data and an improving economic growth outlook has moderated previously more aggressive rate cut expectations. Normalizing economic conditions, and moderating inflation in particular, remain the key catalysts for managing policy rates down to more normal levels. The Fed uses interest rate policy to carry out its maximum employment, price stability and moderate long-term interest rate mandates.

Some investors and members of the media wondered whether the presidential election results will impact the Fed's policy decisions. Chairman Jerome Powell addressed this during the press conference. He said, "The election will have no effects on our policy decisions ... In principle, it's possible that any administration's policies or policies put in place by Congress could have economic effects that over time would matter for our pursuit of our dual mandate goals. So along with countless other factors, forecasts of those economic effects would be included in our models of the economy and would be taken into account through that channel.

In addition to the election having no imminent impact on policy decisions, it is also unlikely to impact the near-term makeup or structure of the Federal Reserve. Politicians on both sides of the political spectrum have criticized Fed chairs from time to time, including President-elect Donald Trump. However, Powell's term does not end until 2026, and today he said he would remain at his post until then. Presidents do not have the legal ability to remove Fed chairs and have limited influence over the structure of the Fed. As such, we do not anticipate any material changes to Fed leadership in the near term.

Despite recent rate cuts, current monetary policy likely remains restrictive. Powell stated, "We're in the process of moving policy rates down to a more neutral level." Economists and the Fed refer to neutral interest rates as a level that neither artificially boosts nor hinders economic activity. Powell acknowledges current interest rate levels modestly drag on activity, even after today's rate cut. Aggressive policy tightening in the form of rate hikes between early 2022 to mid-2023 helped drive the Core Personal Consumption Expenditures Price Index (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% year-over-year in 2022 to 2.6% in September. The headline Consumer Price Index, another widely followed inflation measure, has decelerated from a high of 9.1% in 2022 to 2.4% in September.

The Fed is currently allowing to runoff, or mature without replacement, up to $25 billion per month in Treasuries and $35 billion per month of mortgage bonds from their inventory. This reflects a drop from the previous pace of $60 billion per

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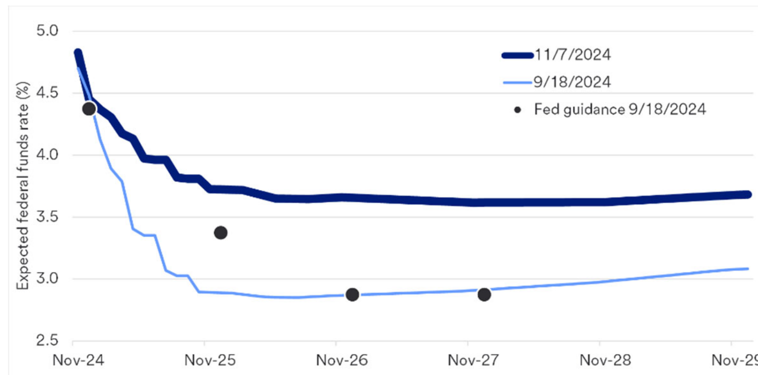
month in Treasuries as of June. Many anticipate this runoff should decelerate further or cease altogether in the first half of 2025. Slower or no balance sheet runoff improves market liquidity, which refers to the amount of money readily available to buy goods, services and financial assets in an economy. Shorter-term liquidity measures modestly improved in the last month and should remain constructive into early 2025. The Treasury Department's cash balances remain elevated and near target balances, meaning there is ample cash awaiting deployment via government spending, which can boost liquidity in the near term.

### Market pricing of the expected path of the federal funds rate

Source: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg; 9/18/2024-11/7/2024




Stock prices added to Wednesday's post-election gains before the Fed's announcement and continued rising afterward, due to no meaningful surprises in the announcement or press conference. Treasury bond yields had begun falling today before the Fed's announcement, reversing a portion of the previous day's move. Yields continued trending slightly lower post-announcement. Large company stocks, represented by the S&P 500, rose 0.7% while small stocks fell slightly after the previous day's large increase on election results. Ten-year Treasury bond yields fell 0.1% to 4.33% today, while two-year Treasury yields fell 0.06% to 4.2%.

Monetary policy, defined as central bank target interest rates, remains restrictive in most geographies around the globe. However, policy has begun gradually easing; as central bank rate cuts exceeded hikes starting in the fourth quarter of 2023 as inflation began trending lower. Investors anticipate modest interest rate cuts from other major central banks in addition to the Fed.

### Global net central bank interest rate hikes (net hikes minus cuts), quarterly

Source: U.S. Bank Asset Management Group Research, Factset; 6/30/2006-11/7/2024

We retain a constructive outlook for diversified portfolios due to still-solid corporate profits, an improving economic growth trajectory, lower inflationary pressures and easing monetary conditions while acknowledging the labor market is easing somewhat. Robust consumer and business activity translated into stronger-than-expected economic data, and consensus economist forecasts call for a smooth and slower trajectory of real (inflation-adjusted) growth settling near 2% in coming quarters. In aggregate, consumer activity remains near normal historical levels, driven disproportionately by wealthier cohorts. Moderating inflation trends remain clear despite stimulative fiscal policy in the form of deficit spending amid increasing government debt. We will keep you informed of our views as incremental data becomes available and as we update our assessment of market conditions.

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