The Pivotal FOMC Meeting: Time to Recalibrate Monetary Policy

Summary

- The FOMC cut the policy rate by 50bps to 4.75%-5%, starting a shift towards a neutral stance to ensure price stability and prevent further increase in unemployment.
- Fed Chair Powell downplayed recession fears. Key projection updates include a higher long-run neutral rate and an accelerated easing pace.
- Expect continued declines in US policy rates and Treasury yields. This trend may extend to other developed markets. Investors should maintain a long-term perspective on fixed income investments.
- Equity investors will welcome the accelerated easing pace, as it addresses slowdown concerns, lowers borrowing costs, and increases the likelihood of a soft landing in the US economy, with positive effects on emerging markets.

It's time to recalibrate

The FOMC has reduced the Federal Funds Rate by 50bps to a range of 4.75%-5%. While somewhat priced-in by bond markets, many experienced Fed watchers interpret a 50bps move an unusual step. This decision marks the beginning of a shift towards a neutral stance, with a series of rate cuts anticipated. The goal is to achieve price stability and prevent an increase in the unemployment rate by the end of 2026.

At the press conference, Fed Chair Powell downplayed concerns about an economic downturn, aligning with the new FOMC projections, which show minimal adjustments to the median GDP growth, unemployment, and PCE inflation forecasts.

Notable changes include a higher median longer-run neutral rate of 2.88% (up from 2.75%) and an updated dot plot indicating an additional 50bps in rate cuts by the end of 2024, 100bps more by the end of 2025, and a further 50bps by the end of 2026 – 100bps in 4 months of 2024 followed by another 100bps in 2025 implies an accelerated pace of easing this year, possibly addressing current slowdown concerns.

Nevertheless, the overall message was slightly less dovish than anticipated, leading to only mild adjustments in US Treasury yields. Powell emphasized that the forecasts do not indicate any urgency and that the Fed is not behind the curve in easing. He cautioned investors against assuming that the current pace of easing will continue. Future decisions will be made on a meeting-by-meeting basis, with the possibility of a “pause if that is appropriate.”

Anticipate a continued decline in yields

We project a continued downward trend for both the US policy rate and US Treasury yields, targeting an exit level of 3.50% for the 10-year UST and 3.80% for the 30-year UST by the end of 2025. These targets may be revised lower if signs of a worsening economic slowdown emerge.

We also anticipate that the downward pressure on fixed income yields will extend to other developed markets, including the EUR, AUD, and GBP. Investors are advised to adopt a long-term perspective and maintain their fixed income investments throughout the easing cycle.

An equity-friendly move

As markets are focused on slowdown concerns, equity investors will welcome an accelerated pace of easing, as it signals the Fed is willing to act early rather than react to incoming data. Furthermore, lowering borrowing rates more aggressively now helps interest-rate sensitive spending and reduces corporate borrowing costs, and raises the likelihood of a soft landing in the US economy.

The stronger emerging market currencies resulting from the rate cuts also help EM assets, and we expect this easing cycle to have positive spillover effects on monetary policy in emerging markets and their assets. So, despite markets being on a data watch for a weak US economy, an aggressive start to an easing cycle is on balance positive for equity markets.

Gold

In recent weeks, gold has steadily climbed as the yields on the alternative safe haven, Treasury bonds have fallen. More recently, gold has hit a new all-time high of 2,620/oz on escalating hostilities between Israel and Lebanon, which Israeli leaders describe as a 'new phase' in the war.

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