Fed Cuts: One Slice at a Time

As expected, the FOMC today announced a cut of 25 basis points in the federal funds rate, lowering the rate to 4.50%–4.75%. U.S. election results suggest we could see looser fiscal policy and new trade tariffs ahead, which might lift growth as well as inflation.

Authors	Date	Topic
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Key takeaways

- We expect the Fed to stay vigilant in monitoring inflation—the fight may not be over just yet.
- The market now prices the federal funds rate at 3.85% by the summer of 2025, which looks realistic to us.
- With the U.S. election uncertainty largely over, we expect the equity rally to broaden, and our outlook for higher-yielding bonds remains favorable.

Today, the Federal Open Market Committee (FOMC) announced a cut of 25 basis points (bps; 100 bps equal 1.00%) in its key interest rate, the federal funds rate, lowering the rate to 4.50%–4.75%. The cut was widely expected based on recent inflation progress, and while economic data remain robust, it was broadly welcomed as a sign that the Federal Reserve (Fed) is keen to bring inflation-adjusted yields down further. A Republican sweep seems very likely, and looser fiscal policy as well as trade tariffs might lift not only growth but also inflation. Market expectations for a December rate cut have moved down.

That said, the inflation rate has continued to improve. While the Fed's preferred measure of prices, the Personal Consumption Expenditures (PCE) Price Index, has remained stable over the past several months, the core PCE Price Index (which excludes food and energy) remains slightly elevated. This will likely lead to a less aggressive rate-cutting cycle compared with what the market was expecting back in September when the Fed started its cuts.

The key data points we're monitoring concern the labor market—the key challenge for the U.S. economy moving forward. Monthly nonfarm payroll numbers have been more volatile lately due to various strikes and the devastation caused by hurricanes, but there is also an overall weakness in professional and business hiring. The U.S. unemployment rate, which has steadily increased in 2024, ticked up to 4.2% in September. Forward-looking growth indicators for the U.S. manufacturing sector worsened again lately while the services sector stabilized, painting a picture of a gradually weakening economy.

We expect the Fed to remain vigilant in monitoring inflation as the fight might not be over just yet. Beyond 2024, the interest rate market continues to price more rate cuts, although nearly two rate cuts have been priced out since September's cut. The market now prices the federal funds rate at 3.85%, instead of 3.50%, by the summer of 2025. The current market pricing looks realistic to us.

We continue to like equities—especially the cheaper parts of the U.S. equity market (excluding mega-cap U.S. technology equities). We expect the equity rally to broaden and believe that any relief from perceived looser monetary policy would likely support equity prices in the medium term. With the uncertainty around the U.S. elections now eliminated, the outlook for higher-yielding bonds remains favorable as a U.S. recession looks less likely under a Republican president and Senate.