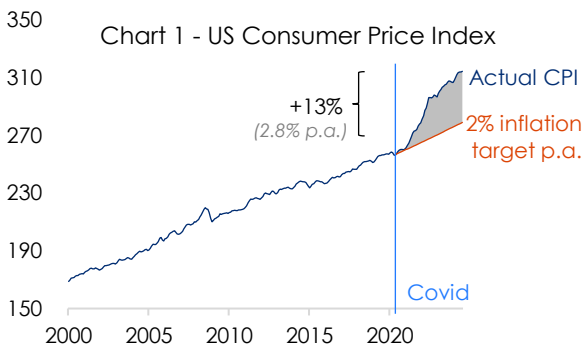


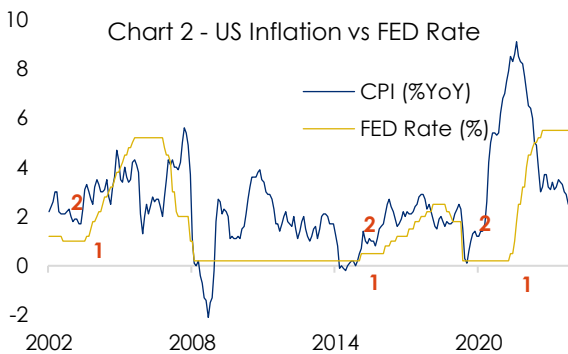
## US FEDERAL RESERVE RATE CUT

The US Federal Reserve (FED) cut its federal funds rate by 50bps, from 5.5% to 5%, after over 2 years of tightening conditions to fight the highest US inflation recorded since the 1980s.

This hiking cycle's purpose was to cool down the US economy and fight inflation. The first rate hike was announced in March 2022, exactly 1 year after FED chairman Jerome Powell claimed that "These one-time increases in prices are likely to have only transient effects on inflation". US consumer price index (CPI) peaked at 9.1% year-on-year in June 2022 and has grown 23% since pre-COVID (an acceleration not seen since the 1970s). Chart 1 shows that US citizens suffer today from consumer prices that are 13% higher than projections of the FED's 2% inflation target since pre-COVID levels, the origin of the shock.



The FED was wrong, causing critics for being late to hike rates. Chart 2 shows that in the current cycle, the first hike (1) came late after the pickup in inflation (2), unlike previous cycles.

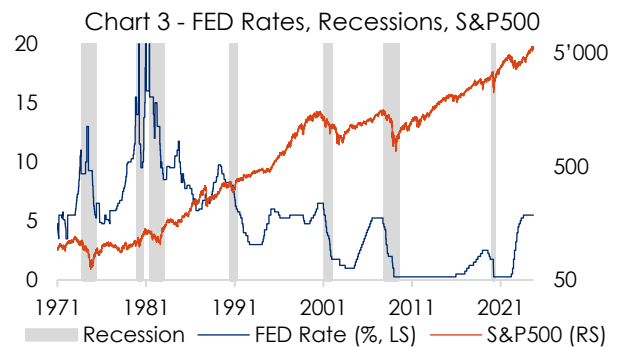


Back in 2022 it seemed like the FED had to choose between keeping high inflation (i.e. not hiking enough to cool down the economy) and causing a recession

(by hiking too much). Worst-case scenario would have been stagflation (no economic growth coupled with inflation) a situation where cutting rates would fuel inflation and hiking would cause a recession. The idea of a soft landing (achieving target inflation and avoiding a recession) seemed back then utopic for most.

While disinflation has been achieved so far (lower pace of prices increases, from a peak of 9.1% to currently 2.5% year-on-year), Powell has repeatedly claimed that the fight is not over until the 2% annual inflation target is not reached.

Every time in the past that the FED cut rates, it was because of deteriorating economic conditions that were reflected in equity markets weakness. 2024 could be an exception to this rule dating back over 50 years of US monetary policy. Indeed, the FED cut its rate despite no meaningful sign of US economic slowdown (although pressure on the job market have increased) nor recession. Correlation does not mean causality; this time rates cuts may not be accompanied with equities selloffs. The US economy is still expected to grow 2.5% for 2024 and 1.7% for 2025 in real terms, according to market consensus.



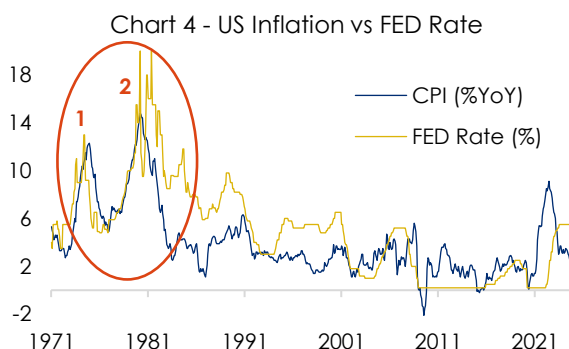
There is little history of successfully engineered soft landings by the FED after tightening cycles greater than 250bps. In the mid-1960s, economic growth continued for several years before the 1970 recession. In 1983-1984, growth persisted until a recession finally happened in 1990 and post 1994-1995, growth even accelerated until it ultimately plunged in 2001. But the aftermath of a tightening cycle usually ends up with an inevitable recession in the following quarters.

The Swiss National Bank was the first developed central bank to cut rates in 2024. China's did mid-2023 to try to revive its economy and Europe's was autonomous and cut rates also this year regardless of the FED's decisions, in a context of slowing growth in the Zone. Since then, most central banks have followed.

Table 1 – Central Banks' Rates

	Rate	Previous	Change
Canada	4.25%	4.5%	Sep 2024
China	3.35%	3.45%	Jul 2024
Europe	3.65%	4.25%	Sep 2024
Japan	0.25%	0.1%	Jul 2024
Switzerland	1.25%	1.5%	Jun 2024
UK	5%	5.25%	Aug 2024
USA	5%	5.5%	Sep 2024

The challenge going forward for the FED is to avoid a monetary policy mistake, i.e. cutting rates too fast or too slow. It is difficult to believe that the ghost from the Volcker-era is not haunting Powell, who would not want to repeat the same mistake when they cut rates in the 1980s, causing an even stronger second wave of inflation (Chart 4).



Updated FED dots plot shows 50bps of additional cut by the end of 2024 and 100bps in 2025 (to 3.4%), before settling at 2.9%. Markets are now pricing 75bps of cuts in 2024. Market data has a significance in the short term, but it is difficult to rely on expectations 2-3 years out as precise economic conditions are unknown and the further out in the future the more uncertain.

Table 2 - Market Expectations for FED Rates

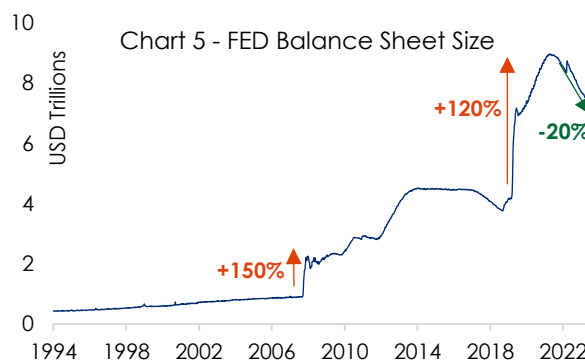
	4%	4.25%	4.5%	4.75%
Nov24			34%	66%
Dec24	18%	51%	31%	

The future will tell whether the FED, after being late to hike rates, was timely to cut and achieve a soft landing. Economic uncertainty going forward might increase

given the US presidential elections. The resulting FED actions might differ based on the program of the elected president.

Market reaction to Powell's comment was muted. Changes in the FED statement compared to June's include that job gains have slowed and FED members gained greater confidence of US inflation's convergence towards the 2% goal. Upside risk to inflation has decreased and downside risks to unemployment have increased, hence the 50-bp rate cut. A short majority of FED members project another 50-bp cut in 2024. Also, the FED will continue to decrease its balance sheet at the same pace. Finally, Powell insisted on the FED's commitment to maximum employment.

The net effects on the US economy and markets depend on the broader FED policy picture, which includes liquidity injections and the size of the FED's balance sheet. We may therefore interpret that yesterday's cut was a hawkish one, given no changes to balance sheet reduction and the fact that Powell insisted that 50-bp was not a standard for future action. Chart 5 shows that the FED has decreased its balance sheet by 20%, still 70% higher (40% in real terms) than pre-COVID levels and 700% higher (450% in real terms) than pre-2008 levels.



Our take on the mid-term effects has showed again that he is rather markets friendly. Indeed, he delivered what markets asked and we expect him to continue to do so. We expect a soft landing of the US economy, which is supportive for risky assets. The impact for bonds is more ambiguous, with a risk of curve bear-steepening should inflation pick up again. The US dollar impact might be a depreciation against currencies whose central banks have more hawkish tones.

Sources: Bloomberg

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