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FOMC begins removing policy restraint with 50-basis point rate cut in September

Transcript

Kathleen Navin: Welcome to this edition of *Take Five with the St. Louis Fed*. I'm Kathleen Navin, senior business economist, and today I'll be discussing the latest FOMC meeting that took place on September 17 and 18.

The big news at the latest FOMC meeting was the Committee's decision to lower its target range for the federal funds rate by 50 basis points to 4¾% to 5%. In talking about the reasons behind lowering the federal funds rate target by 50 basis points, the chair referred to this as a recalibration in monetary policy. And specifically, he stated, "This recalibration of our policy stance will help maintain the strength of the economy and the labor market and will continue to enable further progress on inflation as we begin the process of moving toward a more neutral stance."

And indeed, in the policy statement, the Committee referred to finally gaining enough confidence, and we know that was a requirement going into beginning to remove policy restraint. So they noted the greater confidence that they now have, that inflation is on a sustainable path to 2%. And the statement also noted that currently, the Committee views risks around the dual mandate—so for a stable 2% inflation and for maximum employment—that they view those risks as balanced.

And in talking about the decision, Chair Powell commonly referenced the notion that the decision at the September meeting is intended to keep the economy in a good place. So he referred to the economy as currently in a good place with solid growth, solid labor markets, and declining inflation, and that really this was intended to keep it there.

So let's take a look at some of the latest economic projections, which were also released at the September meeting. These are known as the Summary of Economic Projections, or SEP for short. For the latest Summary of Economic Projections, real GDP growth is expected to be steady, at 2% from 2024 all the way to 2027. And this is an extension of previous forecasts, which only ran through 2026; so now we have an additional year of insight. And we see that growth is steady, so moderating from the 3.1% growth we had in 2023 to a steady 2% growth. And this was generally consistent with the forecasts that were released in the June meeting, just a slight downward revision to that 2024 number from 2.1% to 2%.

Turning now to labor markets, the latest projections for the unemployment rate showed an upward revision relative to the June projections, so a bit of a softer labor market in

this current projection. What we see is that the median projection of the Committee is for the unemployment rate to rise from 4.2% as of August to 4.4% by the fourth quarter of this year, where it remains in 2025 before beginning to gradually move down to 4.2%, which is consistent with the Committee's view of unemployment in the long run. So this is an upward revision relative to what we saw in June.

And what we see on the inflation front is that the median projection for PCE headline inflation is that it will continue moderating, reaching 2.3% in 2024, 2.1% in 2025, and then 2% in 2026, where it holds steady in 2027. And 2% is the FOMC's inflation objective, so reaching objective by 2026. And the revisions for 2024 and 2025 were both revised down relative to the June set of projections.

Turning now to core PCE inflation, which removes the volatile components of food and energy, we see a similar moderation back to 2% over the forecast horizon. So the median projection is that core PCE inflation will be 2.6% this year, moderating further to 2.2% in 2025 and then reaching 2% in 2026. And similar to the projections for headline inflation, these were revised down a bit from the June set of projections by a few tenths.

So what does that mean for the appropriate path of monetary policy? Well, we know that FOMC participants, in addition to giving their forecast for GDP, unemployment, and inflation, also submit projections for the appropriate path of policy, given those forecasts. And what we see in the median projection in this latest set, released in September, is an expectation that policy restraint will continue to be removed over the coming years. So following the reduction of 50 basis points in the target range in September, the median projection is that the federal funds rate will reach 4.4% by the end of the year, essentially implying another 50 basis points in rate cuts by the end of the year.

Now markets, as of Wednesday's close following the announcement, were seeing a little bit more easing relative to the Summary of Economic Projections, with market pricing anticipating about 70 basis points of additional cuts. But we know that these fluctuate and follow incoming data, so we'll continue to watch those going forward.

Now, turning back to the Summary of Economic Projections, we see a further decline to 3.4% by the end of next year, so another 100 basis points in policy easing over 2025 and then a further 50 basis point reduction over the course of 2026, bringing the federal funds rate to 2.9%, which is consistent with the median projection for the federal funds rate in the longer run. So essentially getting back to that neutral rate in 2026, where it remains in 2027. And that estimate of the federal funds rate in the longer run was revised slightly higher relative to the previous set of projections, when it was 2.8%.

So what does this mean overall? Well, we know that the FOMC is continuing to look at the future path of policy on a meeting-by-meeting basis. So that much hasn't changed. That was reiterated in the press conference following the release of the meeting. And what we also know is that incoming data, the evolving outlook, and the balance of risks will be continued to be factored in as we think about the pace of easing going forward. So while the easing cycle has been started at the September meeting, we'll continue to look to those incoming information as we think about the pace going forward and continuing to watch for that in upcoming meetings.

Now when we look at other market interest rates—let's say Treasury yields, for example—well, shorter-term Treasury yields did decline on this latest announcement. But medium- to longer-run Treasury yields actually moved a little bit higher, on balance, on that Wednesday following the announcement.

Now what we know, though, is that policy rates—while they hadn't changed until September—market rates had already been factoring in the move. And so we had already seen a quite substantial decline in the 10-year Treasury yield, for example, from the July meeting to the days leading up to the September meeting. And so what we see is they had already come down around 40 basis points or so—and so a slight increase on Wednesday, about 5 basis points, but still much lower than they were as of July. And we know that has important implications for private yield, such as corporate borrowing rates and also for mortgage rates. So we'll continue to watch those data.

That concludes this installment of *Take Five with the St. Louis Fed*. Thank you so much for joining us.

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