US Daily: September FOMC Recap: Rate Cuts Begin with a 50 (Mericle)

- The FOMC delivered a 50bp rate cut today, against our expectation of a 25bp cut. We see 50bp as the right move in light of the good inflation news and the risk of further labor market softening. The leadership appears to have pushed through a larger cut even though many participants seemed to indicate that they preferred a smaller cut in their submissions to the dot plot. The rationale for the larger cut and the key theme of the meeting was the shift in focus from inflation risks to employment risks in light of the recent softening in the labor market data.
- The greater urgency suggested by today's 50bp cut and the acceleration in the pace of cuts that most participants projected for 2025 makes a longer series of consecutive cuts the most likely path, in our view. We have therefore revised our Fed forecast to accelerate the pace of cuts next year and now expect a longer string of consecutive 25bp cuts from November 2024 through June 2025, when the funds rate would reach our terminal rate forecast of 3.25-3.5% (vs. our previous forecast of consecutive cuts this year but quarterly cuts next year).
- We see the choice between a 25bp and 50bp cut in November as a close call. The deciding factor will likely be the next two employment reports, the second of which will come during the blackout period, and in particular the path of the unemployment rate, where twelve of nineteen participants said they see the risks to even their new higher forecasts as tilted to the upside.

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September FOMC Recap: Rate Cuts Begin with a 50

The FOMC delivered a 50bp rate cut today, against our expectation of a 25bp cut. Chair Powell argued that the logic for the larger cut was clear "both from an economic standpoint and also from a risk management standpoint." We agree that 50bp was the right move in light of the good news on inflation and the risk of unwelcome further labor market softening.

The leadership appears to have pushed through a larger cut in spite of many participants' preference for a smaller cut. Nine of nineteen participants projected that 75bp of total cuts would be appropriate this year, which we interpret as a soft dissent against today's move because it is much more likely that they preferred a path of 25/25/25 than 50/25/0 for September, November, and December. It is also possible that other participants favored a 25bp cut but chose not to subtly dissent in this way. While Governor Bowman was the only voter to formally dissent, her dissent is notable because it was the first by a governor since 2005.

The rationale for the larger cut and the key theme of the meeting was the shift in focus from inflation risks to employment risks in light of the recent softening in the labor market data. Powell highlighted in particular the July and August employment reports and the revisions to payrolls based on the QCEW and said that the FOMC might have cut at its July meeting if it had seen the July employment report by then.

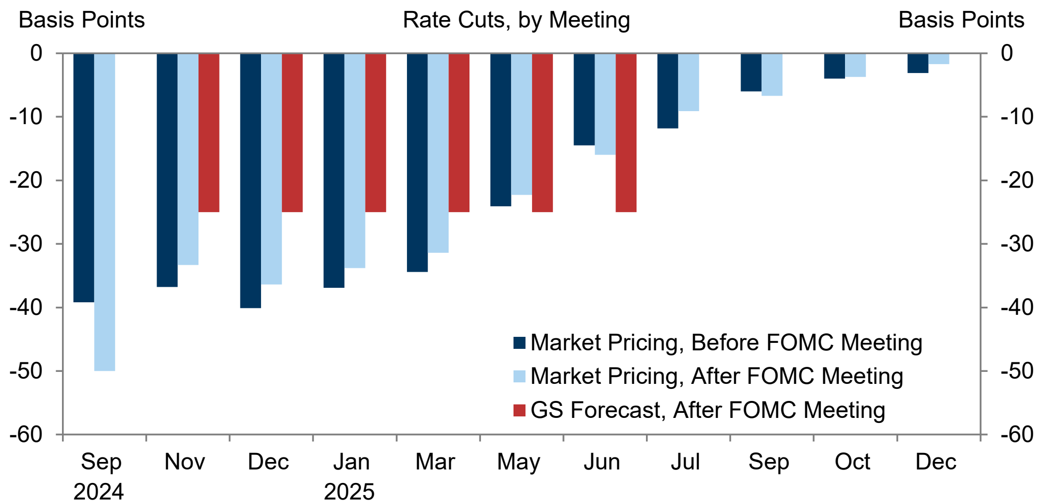
Powell did not sound alarmed about the labor market, though we suspect he was at pains to avoid giving markets the impression that today's larger cut was a negative signal about the Fed's view of the outlook.

The median dot implied another 100bp of rate cuts in 2025, but we see this as a somewhat misleading consequence of aggregating individual projections because twelve of nineteen participants appear to have projected five or six cuts in 2025, up from just two at the June meeting. The greater urgency suggested by today's 50bp cut and the acceleration in the pace of cuts that most participants projected for 2025 makes a longer series of consecutive cuts the most likely path, in our view.

We have therefore revised our Fed forecast to accelerate the pace of cuts next year. We now forecast a longer string of consecutive 25bp cuts from November 2024 through June 2025, when the funds rate would reach our terminal rate forecast of 3.25-3.5% (vs. our previous forecast of consecutive cuts this year but quarterly cuts next year).

The bond market is now pricing 31-36bp of rate cuts for each of the next four meetings, a bit less than before today's meeting but still implying a meaningful possibility of additional 50bp cuts (Exhibit 1).

Exhibit 1: We Now Expect a Series of Consecutive 25bp Cuts Through June of 2025; the Market Is Now Pricing 31-36bp of Cuts for Each of the Next Four Meetings, a Bit Less Than Before Today's Meeting



Source: Goldman Sachs Global Investment Research

We see the choice between a 25bp and 50bp cut in November as a close call. Powell pointed to the SEP—where the median dot implies 25bp cuts in November and December—as "a good place to start" and said that 50bp should not be assumed to be the new pace, but he emphasized that the FOMC will be "making decisions meeting by meeting based on the incoming data."

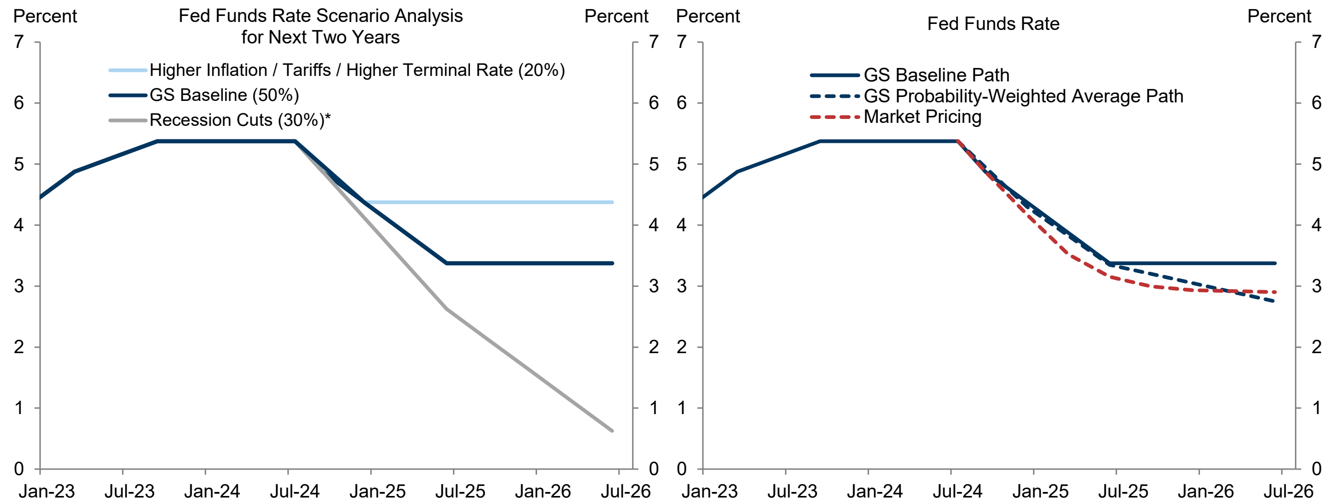
The deciding factor will likely be the next two employment reports, the second of which will come during the next blackout period. Powell highlighted that the unemployment rate in particular is probably "the single most important" indicator.

The new economic projections show a median unemployment rate forecast of 4.4% in 2024 and 2025. While one could interpret this to mean that FOMC participants already anticipate another two-tenths increase this year and nevertheless favor only 25bp cuts at future meetings, we are hesitant to draw that conclusion for two reasons. First, we think another 50bp cut probably would be the right response in that scenario, and we suspect the leadership would agree. Second, further increases might make participants nervous that the unemployment rate could overshoot their projections, especially because twelve of nineteen said they that see the risks to even their new higher forecasts as tilted to the upside.

Our analysis of labor market trends also suggest that the near-term path of the unemployment rate is a very close call. Our estimate of underlying trend job growth fell to 120-130k per month after the August employment report, while our estimate of future labor force growth is 150-180k. We expect job growth to rebound in coming months, but if it doesn't, this would imply that the unemployment rate would trend higher at a rate of 2-3bp per month.

Our revised probability-weighted Fed forecast is close to our new lower baseline path and only slightly less dovish than market pricing (Exhibit 2). We see the path next year as quite uncertain and likely to depend on the race between job growth and labor force growth, further progress in returning inflation to target, and possible fiscal policy changes in the aftermath of the upcoming elections.

Exhibit 2: Our Revised Probability-Weighted Fed Forecast Is Close to Our New Lower Baseline Path and Only Slightly Less Dovish Than Market Pricing



* This is the probability of a recession happening at any point over the two-year horizon shown above. Our 12-month recession probability is 20%.

Source: Goldman Sachs Global Investment Research

David Mericle

Disclosure Appendix

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We, Jan Hatzius, Alec Phillips, David Mericle, Ronnie Walker, Manuel Abecasis, Tim Krupa, Elsie Peng and Jessica Rindels, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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