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Fed Cuts by Half a Percent and Signals More Cuts by Year-End, Rates to Fall Further in 2025

- **The Fed cut their policy rate by half a percent at today's decision; before the decision, forecasters had expected a cut but been split on whether it would be a half percent or just a quarter percent.**
- **The Fed's Dot Plot signals policymakers are likely to cut rates a quarter percent at each of the next two meetings, and by at least another percentage point in 2025.**
- **The median FOMC member also expects higher unemployment over the next three years and lower inflation than they expected in June.**
- **The Fed's policy statement indicates they are putting equal weight on supporting the job market and controlling inflation after focusing squarely on inflation over the last few years.**
- **Interest rates will be substantially lower soon and sustain the economic expansion into next year.**

The Federal Open Market Committee or FOMC voted 11-1 to cut the federal funds rate target by half a percent at today's decision, to a range of 4.75% to 5.00%. The Fed was universally expected to cut interest rates at the decision, but it was unclear whether they would opt for a cut of a quarter percent or this larger, half-percent cut.

The Fed also released an updated Summary of Economic Projections ("Dot Plot") at today's decision, showing that the median member of the rate-setting committee expects cooler inflation and higher unemployment in coming quarters than they expected in June, the last time the Fed released a Dot Plot. The median projection for PCE inflation in the fourth quarter of this year was cut to 2.3% from 2.6% in the June Dot Plot, and the median for next year cut to 2.1% from 2.3%. The median projection for Core PCE inflation excluding food and energy was cut to 2.6% in the fourth quarter of 2024 from 2.8% previously. The projection for the fourth quarter of 2025 was cut to 2.2% from 2.3%. The projection for the unemployment rate was raised to 4.4% in the fourth quarter of this year from 4.0% in the June Dot Plot, and for the fourth quarter of 2025 was raised to 4.4% from 4.2% previously.

The FOMC changed the wording of their monetary policy statement to show that they are attaching equal importance to supporting the labor market and controlling inflation, a change from their single-minded focus on fighting inflation between 2022 and early 2024. Where the previous statement said, "The Committee is strongly committed to returning inflation to its 2 percent objective," the new statement reads, "The Committee is strongly committed to **supporting maximum employment** and returning inflation to its 2 percent objective" (Our emphasis on the changed wording).

Since the Fed last met, there were big downward revisions to the jobs statistics that show the labor market is not as strong as previous data indicated. Considering the downward revisions in the August jobs report, as well as the Preliminary Benchmark Revision to payrolls announced in mid-August, job growth in the 12 months through August was just 157,000 per month, much slower than the 218,000 12-month average through June in the latest data available when the Fed met previously on July 30 and 31.

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Also, inflation is slowing more than FOMC members had dared to hope, largely due to a big drop in gasoline prices that has continued through mid-September. U.S. energy production is strong amid rapid advances in oil-producing technology and rapid adoption of solar energy, while energy demand is sluggish around the world, especially in Europe and China. That has brought down prices of gas and diesel despite ongoing supply restraint by OPEC+ producers and uncertainty caused by the wars in the Mideast and Ukraine.

Core inflation has slowed less than total inflation, with core CPI excluding food and energy still up 3.2% in year-over-year terms in August and core PCE inflation up 2.6% in the latest release, which if for July. Part of this is because shelter cost inflation continues to run faster than in the pre-pandemic period. Looking forward, leading indicators of households' average shelter costs like house price indexes and asking rents for new leases have cooled, suggesting that shelter inflation will slow in 2025, too (Shelter CPI peaked at an 8.2% year-over-year increase in March 2023, and slowed to 5.2% in August 2024).

The other reason core inflation is still running hot is that core service prices excluding housing and energy (Sometimes called Supercore CPI or Supercore PCE inflation) also are rising faster than before the pandemic. There are chronic shortages of workers who work physically-demanding face-to-face service jobs. That has kept inflation of food services, daycare charges, and the cost of in-home eldercare high even as other types of inflation has slowed. But with the unemployment rate averaging 4.2% in the last two months and earnings growth slowing, the Fed seems to expect this source of inflation to cool as well over time.

As the Fed pivots, interest rates will fall substantially over the next six to twelve months. That is very welcome news for credit-sensitive sectors of the economy like housing, manufacturing, and retailing of cars and other big-ticket consumer products, which bore the brunt of high rates. Those sectors are a coiled spring that will bounce back as interest rates fall, sustaining the current economic expansion into 2025.

Following the big September Fed rate cut, Comerica forecasts for the Fed to cut their target rate another quarter percent at the next two decisions, in November and December. That will lower the target rate to a range of 4.25% to 4.50% at the end of 2024. Comerica further forecasts for the Fed to cut rates by a quarter percent in January and March 2025, and then make quarterly cuts in June, September, and December, closing 2025 with the target rate at 3.00% to 3.25%.

The Dot Plot shows that the median FOMC member thinks slightly less rate cuts than this will likely be appropriate through year-end 2025. The median Dot tends to support tighter monetary policy than the median voter at FOMC decisions. This is because there are more hard money types among the regional Fed presidents than among the Governors of the Federal Reserve Board in Washington, and every Governor votes at every meeting while only a subset of the Presidents do.

Separately, the Fed held the pace of their balance sheet reduction steady at the September decision, capping runoff of their bond holdings (a.k.a. Quantitative Tightening) at a maximum of $25 billion per month in Treasuries and $35 billion in mortgage-backed securities. The Fed didn't provide substantial new guidance on their asset reductions at the September meeting, and will likely end the runoff of asset holdings in the first half of 2025.

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