

# Fed Watch: September it is

The Fed kept interest rates steady at yesterday's meeting. Yet, Powell was surprisingly outspoken about a September rate cut. With labour market dislocations being gone and progress on disinflation more broad-based, the Fed's dual mandate has moved into better balance. A cut by 25 basis points at the next meeting in September is the Fed's base case, matching our forecast and market expectations. On markets the clear positioning by Powell was perceived as a dovish signal. Treasury yields declined noticeably and the curve steepened.

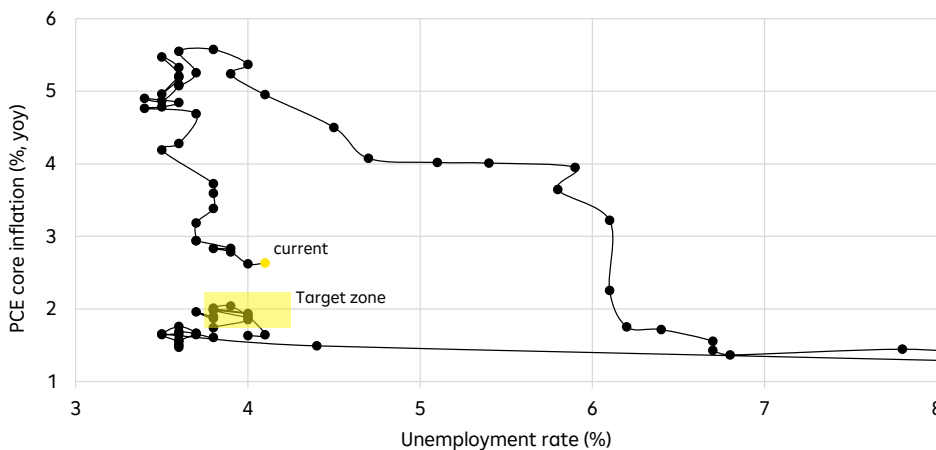
*Fed approaches target range of dual mandate of price stability and full employment* **1**

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*Analyst* **6**



## Fed approaches target range of dual mandate of price stability and full employment



current = June 2024; monthly data since January 2018

Source: LSEG, RBI/Raiffeisen Research

The **Federal Reserve has kept key interest rates constant** at yesterday's meeting. The target band for the federal funds rate stands at 5.25 to 5.5%. This was widely expected and attention was focused on any signal about the rate path for the rest of the year.

The **monetary policy statement** reads almost identical to the one from June. Among the changes it is worth mentioning that the Fed now sees "some further progress" towards the inflation objective while further progress was assessed as "modest" at the June meeting. Thus, we are getting closer to the first rate cut which will occur when the FOMC "has gained greater confidence that inflation is moving sustainably toward 2 percent". Further, the FOMC seems to treat its two objectives (price stability and full employment) more equally. "The Committee is attentive to the risks to both sides of its dual mandate", while in June the Committee was still mainly concerned with "inflation risks". This means that the Fed will equally respond to adverse deviations from any of its two objectives. Or, put differently, inflation has fallen to a low enough level that the Fed might start to cut key interest rates on the basis of deteriorating conditions on the labour market alone. As the

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labour market is seen in a good state, this does not seem to be a pressing risk factor though.

At the **press conference**, Chair Powell was more outspoken about the possibility of a September rate cut than we thought. The economy is moving closer to a point where a rate cut might occur but the Fed "is not quite at that point yet". But should inflation move down more or less as expected, then the Fed would be in a position to cut rates in September. This makes a September rate cut the Fed's baseline, matching our expectation that we had for quite some time. The FOMC even had a real discussion whether to cut rates at this meeting already, which makes a September cut even more likely. On the fundamentals, Powell describes the latest disinflation period (Q2'24) as more promising than the experience in 2023 (H2'23). Back then disinflation was mainly based on an unsustainable disinflation of core goods prices, while now disinflation is much broader and also encompasses services. Setbacks are thus less likely compared to a year ago. On the labour market the Fed doesn't want to see significant cooling from current levels. The labour market is in a healthy non-inflationary state, which is comparable to the situation before the pandemic.

On **markets** the Fed meeting was a dovish surprise. The short-end of the yield curve (2-year) moved by about 10 bps with downside pressure also being visible on the long-end of the curve (10-year) - at a lower magnitude though. The steepening of the yield curve thus continues and the spread between 2-year and 10-year US Treasury yields has already narrowed to -20 bps. Consistent with the downward move in Treasury yields EUR/USD moved up. Dovish Fed surprises are a headwind for the US-dollar.

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
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
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
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
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
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
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
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
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
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