Take 5 Five
WITH THE ST. LOUIS FED

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FOMC cuts again in December, signals more gradual approach moving forward

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 final FOMC meeting of 2024, which took place on December 17 and December 18.

Now, at this meeting, the FOMC decided to lower the federal funds rate target by 25 basis points to a range of 4.25% to 4.5%. We learned during the FOMC press briefing following the statement release that this was a closer call, and indeed, there was one dissent from the FOMC policy decision from Cleveland Fed President Beth Hammack, who preferred instead to hold the federal funds rate target where it was.

Now, overall, since September—so through September, November, and December, over those three meetings—we've had 100 basis points in policy easing this year. The focus now really turns to 2025. So when we look at what guidance is there around what the path of policy may be going forward, we do have some additional insights from the latest FOMC statement: "In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks."

Now, this statement had been pretty close to what was in previous FOMC statements, but there was one addition. And that was the phrasing "the extent and timing of," which essentially is kind of previewing that policy will be more gradual moving forward, that we're now at the time or close to the time when that more gradual approach will be more appropriate. And we're going to talk a lot more about that. There was a lot of conversation around this during the FOMC press briefing, and so this will be a big theme with the December meeting.

Now, to get a little more insight on what that more gradual path of policy could look like, let's take a preview of the summary of economic projections. Here, we have the federal funds rate, both the actual and the median projection. So with 2024 pretty much in the books, we had 100 basis points in easing, bringing that final rate for the end of the year to 4.4%. And then looking forward to 2025, that median projection falls to 3.9%, so 50 basis points in additional easing next year. Now, this was a pretty material change since the September set of projections, where FOMC participants and, specifically, the median had penciled in a total of 100 basis points of additional cuts, so two fewer cuts next year. And then looking forward, we see that the median projection falls to 3.4%, so an additional 50 basis points in easing in 2026,

and then one additional cut in 2027, bringing the federal funds rate to 3.1%, which is pretty close to the latest longer-run estimate of 3%.

Now, it's worth noting that that 3% longer-run estimate has now been revised up a total of 50 basis points from this time last year, specifically the December 2023 meeting. This could reflect a variety of reasons, but it does tell us something about the resilience of the U.S. economy in response to the higher rates we have, essentially suggesting that higher rates, the U.S. economy seems to be able to handle it. So when we look at this, we see that upward revision to the longer-run rate, but we know there's a lot of uncertainty around that.

Now, taking a step back, looking at the latest set of projections, specifically for the federal funds rate, we know this is not a prescribed path, but it does signal a more gradual approach moving forward. And in discussing the slower path for policy going forward, Chair Powell referenced five reasons behind the more gradual path. To start, growth has been stronger. Indeed, through the first three quarters of 2024, real GDP growth rose at an annualized rate of 2.6%. When we look at real GDP growth, specifically from the latest set of economic projections, we see that growth moderates from 2023 to 2024 to 2.5%, and then further moderation to 2.1% and 2% in 2026, a little bit further to 1.9% in 2027, so moving back gradually towards the 1.8% longer-run estimate. And that number for 2024 of 2.5%, that was revised up 0.5 of a percentage point from the projections in September. So we see that expectation of stronger growth through the end of the year carrying in a little bit into next year, so the stronger growth overall in the GDP forecasts.

The second reason behind the more gradual approach moving forward is that the unemployment rate is lower. And when we look at the unemployment rate projections, we see in the most recent path, 4.2% at the end of 2024, a downward revision from 4.4%, and then 4.3% in 2025, where it remains through the rest of the forecast. So with a lower unemployment rate, there's really less pressure on needing to remove policy restraint more quickly to kind of alleviate pressure on labor markets. So what we've seen in labor markets more recently is that we still have had a cooling, but a lot of the downside risk has diminished. And that allows for a little more patience moving forward on policy adjustments.

The third reason provided is that inflation is higher, and this we really see in the latest set of projections. We've had higher incoming data on inflation over the last couple releases, and projections for 2025 were revised up quite a bit. Here, we see for the PCE price index, revised up to 2.5% in 2025. That's up from 2.1%. And when we look at core PCE inflation, we continue to see that moderation towards the 2% target over the next few years but in a much more gradual fashion. And again, we see upward revision for 2024, 2025, and 2026, and this really is one of the main reasons that was discussed about why the need for a more gradual approach to removing policy restraint moving forward.

Now, a fourth reason is that we're simply getting closer to neutral. So now, with 100 basis points in policy reduction, whatever neutral may be, we're getting closer to it. And so as you approach neutral, since it's not a known number, we just want to be more cautious. It's often been referred to that we know neutral by its works. And so having time to analyze the data, see if we're getting closer to that neutral rate—where inflation is steady around 2%, we've reached maximum employment, and there's not pressures either way from moving away from the dual mandate—that's something that you want to do cautiously.

And the fifth reason provided is that there is uncertainty around inflation, and that uncertainty has moved up in recent weeks, in recent months. And when the path is more uncertain, it's simply more prudent to approach things more carefully and more cautiously.

Now, what did markets think about the latest FOMC meeting? Heading into the December meeting, markets had essentially fully priced in the 25-basis-point cut. And we're expecting about 50 basis points in rate cuts next year, which is pretty much what happened in December and was signaled for 2025. But there was a lot of additional parts to the FOMC briefing that markets took to be a little more hawkish. And as a result, intermediate rates and longer-run rates, specifically looking at the Treasury yield curve, they moved up after the release of the statement and the press briefing and, on the day, ended, when we look at the 10-year Treasury, 10 basis points higher.

Now, since the September meeting, if we look at the Monday prior to the September meeting, when the FOMC began removing policy restraint, the 10-year Treasury yield has moved up now about 90 basis points, so just shy of 90 basis points. So essentially, as the FOMC's policy stance has moved toward being easier, we've had a tightening in market rates like the 10-year Treasury yield. And this has important implications for mortgage rates and corporate borrowing rates, so it's something we really want to keep an eye on.

And specifically, as we look toward the path moving forward, we'll be looking and continuing to look at the incoming data. So that data dependency is still very much part of this process, looking at that but also looking at how markets are interpreting events. And that could have implication for Treasury yields and, therefore, mortgage rates and broader financial conditions. So we'll be looking at all of those data moving forward.

Well, that concludes this *Take Five with the St. Louis Fed*. Thanks so much for joining us.

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