

## Fed set to cut 25bp but to signal a slower, shallower path ahead

The Federal Reserve is expected to cut rates by a further 25bp on 18 December as it continues to move policy from restrictive territory to somewhere closer to neutral. However, with inflation remaining sticky, and President-elect Trump looking to strengthen the US growth performance, the Fed is set to signal a more cautious policy easing profile for 2025



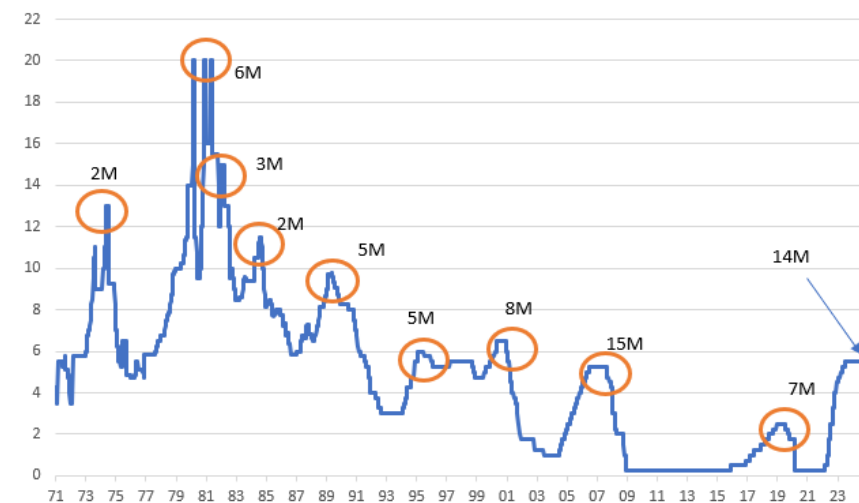
We expect the Federal Reserve to cut rates by 25bp on 18 December and to signal fewer cuts in 2025

### 25bp cut, but fewer cuts signalled for 2025

The Federal Reserve has cut rates 75bp over the past two FOMC meetings and we expect it to cut by a further 25bp on 18 December. They suggest that the long-run expectation for the Fed funds is around 3%, and with the ceiling rate currently at 4.75%, they have room to play with as they move policy from restrictive territory closer to neutral.

Keep an eye on their new economic forecasts though with President-elect Trump's policy thrust of immigration controls, tariffs and personal and corporate tax cuts likely to mean the Fed signals a shallower, slower path of easing through 2025.

## Fed funds target ceiling rate (%) with duration between last rate hike and first rate cut 1971-2024



Source: Macrobond, ING

### Three 25bp cuts in 2025

Up until recently, the market had been fairly split on whether we would indeed get a rate cut in December. Inflation data has not been making any real progress towards the 2% target on the CPI methodology. Four consecutive 0.3% month-on-month prints are far too hot for comfort. However, there has been better news on the Fed's favoured measure, the core personal consumer expenditure deflator. Key components from the CPI and PPI reports that feed through into this broader measure of inflation pressures offer encouragement of a favourable 0.2% MoM print when released on 20 December.

The Fed's dual mandate means that it also needs to pay close attention to what is happening in the jobs market. Clear signs of cooling with payrolls growth slowing, full-time employment actually falling and unemployment shifting higher justifies the Fed moving policy closer towards neutral. With 23-24bp of a 25bp cut priced into futures contracts, it looks a done deal.

### ING expectations for Federal Reserve updated forecasts

	2024	2025	2026	2027	Longer run
<b>Change in real GDP (4Q YoY%)</b>	2.4	2.0	2.0	2.0	1.8
Previous Fed projection (Sep)	2.0	2.0	2.0	2.0	1.8
<b>Unemployment rate (% year end)</b>	4.2	4.4	4.3	4.2	4.2
Previous Fed projection (Sep)	4.4	4.4	4.3	4.2	4.2
<b>Core PCE inflation (4Q YoY%)</b>	2.8	2.3	2.0	2.0	-
Previous Fed projection (Sep)	2.6	2.2	2.0	2.0	-
<b>Federal funds rate (year end)</b>	4.4	3.6	3.1	2.9	2.9
Previous Fed projection (Sep)	4.4	3.4	2.9	2.9	2.9

Source: ING, Federal Reserve

The market will also be focusing on what the Federal Reserve has to say about 2025. The table

above shows what we expect the Fed to suggest versus what they projected in September. Growth and inflation are set to be revised a little higher for end-2024 while unemployment will be nudged lower, but we aren't expecting them to dramatically shift their 2025 forecasts. The near-term growth story is being lifted by the election clarity and a sense that Trump's pro-business regulatory stance coupled with a low tax environment should be supportive, but there is some nervousness regarding the potential impact of trade protectionism and immigration controls.

By the March FOMC meeting, the Fed will have a clearer understanding of President Trump's tariff, tax and spending plans and as such we would expect them to leave major forecast revisions until then. Nonetheless, the risk of slightly stronger near-term growth with the threat of higher inflation – tariffs putting up prices of goods and immigration controls potentially lifting wages and costs in the likes of agriculture, construction and hospitality sectors – means that we expect them to signal only three rate cuts in 2025. Previously they had suggested four. We look for 25bp of cuts per quarter in 2025 with a terminal rate of around 3.75% in the third quarter.

## Technical adjustment in the works for the Fed's reverse repo rate

The minutes from the last FOMC meeting made reference to a possible technical adjustment to the Fed's reverse repo rate. It's currently at 4.55%, and so 5bp above the Fed funds floor at 4.5% (with the ceiling at 4.75%). The suggestion is for the reverse repo rate to be cut by 5bp, bringing it flat to the funds rate floor. Technically what would happen is the Fed funds floor and ceiling rates would be cut by 25bp, and the reverse repo rate cut by 30bp, thus pitching the Fed funds floor and reverse repo rate flat at 4.25%. The other key rate, the interest on reserves, is currently at 4.65%, and so 15bp above the floor. This is projected to also be cut by 25bp, thus keeping spreads versus the floor and ceiling rates unchanged.

So what are the implications of all of this? There are a few moving parts here. First and foremost, the Fed's main job here is to manage the effective Fed funds rate. This is currently at 4.58%. It generally sits between the reverse repo rate and the rate on reserves. The interest on reserves has been the most impactful factor driving the effective funds rate, which is in turn driven by the overnight cash activity of Federal Home Loan Banks. This spread has been steady at 7bp, and is likely to remain so, although if anything, the effect could be to tempt the effective funds rate lower. But on balance, we'd expect the spread to the rate on reserves to hold. That would pitch the effective funds rate 25bp lower at 4.33% via

The main outcome here is a reduced compensation for cash going back to the Fed via the reverse repo facility, which makes that facility less attractive at the margin. In turn, this continues to drive the decline in the use of the facility. That's been the direction of travel in any case. The added benefit is the reverse repo balances head towards zero before eating into bank reserves. Ultimately as bank reserves then fall, the Fed's quantitative tightening programme would be called to a halt. Not something to worry about though until the second quarter of 2025 at the earliest, we think.

## Firm dollar trend to withstand FOMC test

Rate differentials have been a major driver of the strong dollar trend since early October and we doubt the FOMC meeting will deliver any significant dent to the underlying dollar bull trend. Here we do not see any substantial changes in what is priced for the Fed easing cycle and this should keep dollar rate differentials relatively wide.

Instead, the FX market remains in waiting mode ahead of January's inauguration of Donald Trump. The fear/expectation is that he could move out of the blocks more quickly this time when it comes to tariffs – and that tariffs or competitive FX devaluations in response to tariffs are both dollar positive.

The dollar is currently defying seasonal trends for December weakness and we doubt that the FOMC needs to prove itself a negative event risk. Instead, the direction of travel for EUR/USD is clearly lower and perhaps by year-end or early January, EUR/USD should be pressing new lows near 1.02/03.

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