

# Federal Reserve to cut by 25bp irrespective of election outcome

An anticipated close election outcome could prompt significant market volatility, but this won't deter the Fed from cutting interest rates by 25bp on 7 November. Inflation is less of a worry, and the Fed is putting more focus on a cooling jobs market. In turn, we expect it to continue cutting rates closer to neutral irrespective of which candidate wins



Federal Reserve Chair, Jerome Powell. We think the central bank's set on another rate cut next week regardless of whether the US election ushers in a win for Kamala Harris or Donald Trump

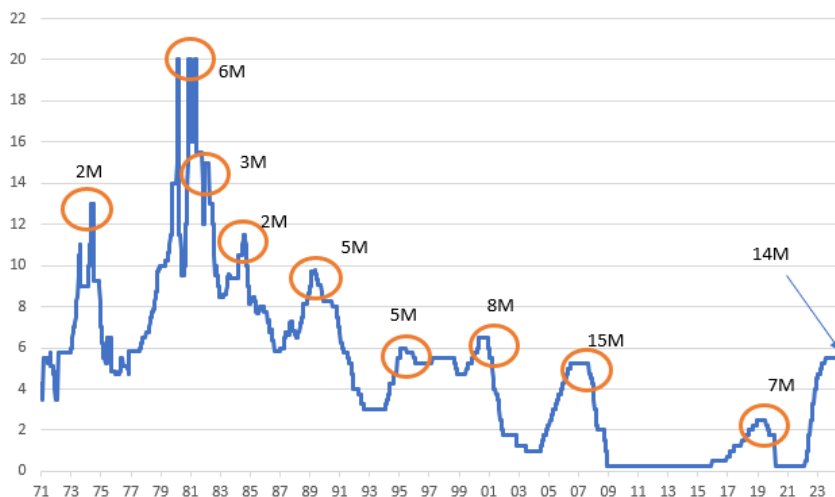
## Fed to cut by 25bp

Tuesday's election is the obvious focus, but we should remember that the Federal Reserve policy decision on Thursday is also going to be a very important market moving event. While a 25bp rate cut is broadly expected and priced for, Fed Chair Jerome Powell's commentary on the current economic environment and how the next US president will likely influence the outlook will be of huge significance.

The Fed will be mindful of how its actions and commentary could influence financial markets that may already be experiencing quite volatile conditions. Markets have appeared increasingly confident of a Donald Trump victory with equities, the dollar and Treasury yields all rising in recent

weeks. If Trump wins, these trends may continue. However, we could see a sharp reversal if Kamala Harris wins as markets move to factor in the prospect of higher taxes and a less favourable business environment, but with arguably more certainty over trade policy and international relations.

## Fed funds ceiling with duration between last interest rate hike in a cycle and the first rate cut (%)



Source: Macrobond, ING

## Policy rates remain well above "neutral"

With regards to the Fed, we agree with the market and expect a 25bp rate cut on Thursday irrespective of the election outcome. The Fed is more relaxed about inflation and is putting more focus on the jobs market as it attempts to secure a soft landing for the economy. Even after September's 50bp rate cut, monetary policy is in restrictive territory, and the Fed has scope to keep cutting rates back to a more neutral level to give the economy a little more breathing space to continue growing strongly. The Fed itself has said nothing to dissuade us from looking for a second consecutive rate cut other than suggesting that the scale of move will indeed be smaller than in September.

Joe Biden will still be president until 20 January, so the macro newsflow will remain the main factor driving the Fed's thinking at the subsequent December meeting. Here, we expect the central bank to also cut 25bp, bringing total easing to 100bp for this year.

## Election has important implications for Fed policy in 2025

Looking longer term, we argue that a Trump victory will ensure a lower tax environment that should boost sentiment and spending in the near-term. However, promised tariffs, immigration controls and higher borrowing costs will increasingly become headwinds through his presidential term. Conversely, a Harris victory implies continuity – but with Congress likely split, her ability to deliver her manifesto will be questionable. Slightly higher taxes and only modest increases in spending may be seen as the best election outcome possible by the Treasury market, but it puts more pressure on the Fed to deliver rate cuts and support growth.

The Fed's Summary of Economic Projections imply that it believes in "neutral" policy rates of around 3%, whereas we think it is probably closer to 3.5% in an environment of loose fiscal policy. With the deficit likely to be close to 7% of GDP this year and next, the Fed may end up feeling that interest rates need to be left somewhat higher to offset the fiscal support in order to hit the 2% inflation target. Given this situation, we are suggesting that we may get to 3.5% Fed funds by the summer if Trump becomes president, but we may see the Fed go a little deeper and cut to 3% in the second half of 2025 under a Harris presidency.

## **No meaningful FOMC reaction for Treasuries - provided 25bp moves per meeting continue**

Provided the rhythm of a 25bp cut per meeting is not upset by anything that the FOMC does or that Chair Powell says, the impact of this meeting is not expected to be particularly pivotal for Treasuries. When we look at the curve, we'd suggest the 2-year yield should be below 4%, and should be settling in the 3.75% to 4.0% range. And we therefore see potential for the curve to steepen from the front end. The 10-year at around 4.25% is more prone to maintaining a heavy tilt, with upside for the 10-year yield still probable until or unless we get some material evidence that the economy is really stalling. The latest weather/strike impacted payrolls report did not give us that, at least not yet. A Trump win sustains that trade. A Harris win reverses it, as would no immediate outcome and acrimony.

In terms of liquidity and the plumbing, the Fed continues to engage in tapered quantitative tightening. It's having an effect, but on a very gradual basis. Bank reserves plus the cash going back to the Fed on the reverse repo facility are running in the area of US\$3.4tr, which is quite comfortable. In fact, we'd read this as representing an excess liquidity of some US\$0.5tr still. Also note that the US Treasury has a cash balance at the Fed of some US\$0.8tr. As they allow this to run down into the early part of 2025 when the debt ceiling is resurrected, liquidity will be injected back into the system. Overall, we'd view liquidity conditions as remaining ample through the coming few months, and we doubt the Fed needs to make any immediate adjustments here.

## **Were it not for the election, FOMC would be a dollar negative**

Having been battered through October, EUR/USD has started to find a little stability as the market questions itself whether it is being too dovish in its pricing of the European Central Bank cycle and not dovish enough in its pricing of the Fed. Were it not for the elections, we would assume the modest drop in short-dated US yields as the market prices in two full 25bp Fed cuts this year would be mildly dollar negative. Equally, the Fed landing rate for this easing cycle has already been repriced to 3.50% from 2.75% over the last five weeks. We doubt there is much more upside risk to the dollar from this adjustment.

Yet the above will be dominated by the fallout from Tuesday's elections. FX markets are currently minded towards a red sweep. Were that not to materialise, we suspect the dollar could be handing back some of its recent gains. A dovish FOMC meeting could add to that trend. Under the latter election scenario, generalised levels of uncertainty and volatility would determine whether it's the defensive JPY and CHF leading the charge against the dollar (under a split Congress or contested vote) or whether high beta G10 and EM currencies would be dominant (under a Harris win.)

## Authors

### James Knightley

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

### Padhraic Garvey, CFA

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

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