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THINK Ahead: 50 basis point rate cuts? How about 200

Should the Fed have just cut to the chase and slashed rates by 200 basis points this week? Don't worry, James Smith hasn't (fully) taken leave of his senses. Read on as he explains why central banks may be forced to go faster, as the team looks ahead to another important week in the world of macro and markets

ING's James Smith on next week's world today

THINK Ahead: 50 basis point rate cuts? How about 200

Here's a question: should the Federal Reserve have cut rates by 200 basis points this week?

Before you tell me I've taken leave of my senses, let me explain the logic of this week's little thought experiment:

The Fed has told us it wants to get rates back to 3%, which it reckons is neither restrictive nor accommodative for the economy. Chair Powell has said in no uncertain terms that he doesn't welcome any further weakness in the US jobs market. So if the Fed – and other central banks for that matter – have concluded rates need to go much lower, why not get there ASAP?

Let's start with the arguments against, of which I see four:

First, there's simply no need to cut rates that quickly. For all the recent recession concerns, the latest numbers look fine. Jobs markets are cooling to varying degrees across the developed world, but we're generally yet to see the telltale rise in layoffs that often proceeds a downturn.

Should we be reassured? Perhaps not. We know in the US that the jobs numbers are overstating the picture right now. Powell himself said this week that he is mentally adjusting the non-farm payrolls lower each month, given they're going to get revised down anyway. My colleague James Knightley also points to the latest Fed Beige Book – a collection of anecdotes from businesses – which indicates more and more areas of the economy are turning weaker.

Second, nobody truly knows what the neutral interest rate actually is in real time. Most central bankers freely acknowledge this. With rates currently so high, nobody is arguing that a 50bp cut is going to get you anywhere near that neutral level. But as rates get lower and lower, it's harder to say that with any real confidence.

Here's the thing though: maybe central banks won't care that much. The incentives of policymakers are shifting rapidly, after all. The nightmares of the 1980s have stopped. Preserving the soft landing is rapidly becoming the priority. If they overshoot the true neutral rate by a few tenths of a percentage-point but manage to preserve the recovery, does it really matter?

Third, central banks worry that big cuts will see more big cuts priced in. Or worse still, investors conclude the central bank knows something everyone else doesn't.

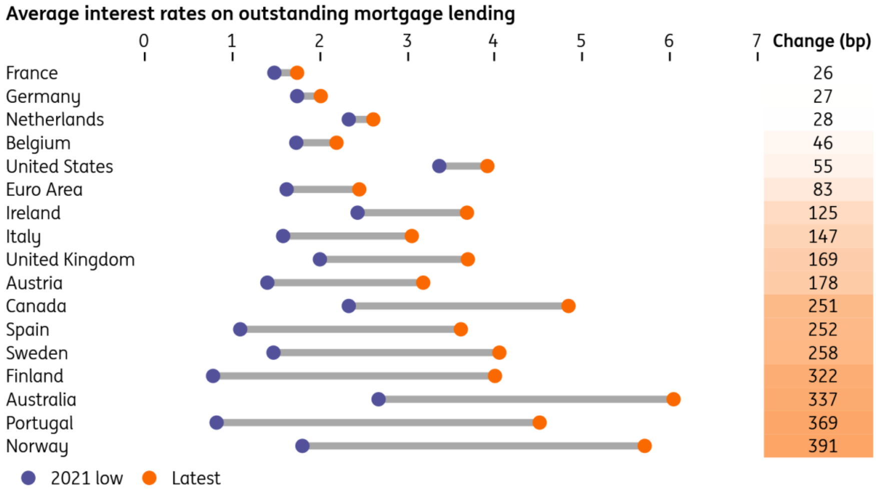
Interestingly, the Fed's 50bp cut this week did neither. The message was that officials should have probably cut in July, so this is them just catching up. Investors aren't fully convinced, but then they weren't before the meeting either. Markets have 75bp of US rate cuts priced by year-end.

Finally, central banks simply don't slash rates unless there is some sort of crisis. That's true, though the Fed showed this week that it's not black and white. It's also not what we saw in the latest hiking cycle. Remember the Fed did four 75bp hikes within six months.

That's a neat segway into what I think is the major argument in favour of my hypothetical 200bp rate cut. The simple fact is that policy changes take longer to hit the economy than they used to. Households and corporates locked in those low rates pre-Covid and a greater share of lending is fixed.

Take a look at my chart of the week: the Fed Funds Rate rose by more than five percentage points from its 2021 low. The average rate households are paying on existing mortgages, however, has gone up by just 0.5% over that same period.

Chart of the week: Rate hikes have hit the US and parts of Europe fairly slowly



Source: Macrobond, ING calculations

This chart shows the average rate paid on the outstanding stock of mortgages. This shouldn't be confused with current mortgage rates being offered by banks on new lending

In days gone by, central banks could cut rates in small chunks and expect quick results. That's much less true today. The level of rates and the length of time they stay there is arguably now more important.

OK, spoiler alert. Neither the Fed nor anyone else is likely to implement a 200bp rate cut any time soon. Nor should they. Sorry if my clickbait headline lured you in...

But here's what I'm getting at. If central banks have decided there's a case to cut rates, a cautious path of 25bp moves risks looking like an awkward compromise. That's my feeling here in the UK, anyway.

Our view is that the cautious approach to rate cuts might not last. We don't rule out another 50bp rate cut from the Fed this year, even if it's not the base case. And we think the ECB and BoE will pick up the pace of cuts over the winter.

The battle on inflation looks won. If policymakers want to save the economic recovery too, maybe it's time to get a move on.

THINK Ahead in Developed Markets

United States (James Knightley):

- The Fed's decision to go for a 50bp cut, but with a clear warning for the market that they should not expect this to be the norm given solid economic fundamentals, has reinforced faith in the "soft landing" thesis. Inflation is slowing and the economy is cooling, which allows the Fed to gradually move policy back to neutral. We are expecting 25bp rate cuts in November and December with the policy rate settling at 3.25-3.5% by next summer.

Nonetheless, we see the risks skewed towards the Fed potentially cutting rates to even lower levels, given the loss of momentum in the jobs market.

Next week's data highlight is the personal income and spending report, with the core personal consumer expenditure deflator the key number within it. Core CPI came in at a relatively "hot" 0.3% month-on-month, but the core PCE should come in at 0.2% given the lower weighting for housing. As such, this should confirm that inflation is not a barrier to interest rate cuts.

Eurozone (Peter Vanden Houte):

- **Purchasing Managers Indices (Mon):** As August's PMI (especially the services component) in the eurozone probably received a temporary boost from the Olympics in France and a strong tourist season in Southern Europe, chances are high that the September reading will see a downward correction. We anticipate a declining PMI both for the services sector and for the composite indicator. As for the manufacturing sector, anecdotical evidence, like Volkswagen's announcement of plant closures in Germany, seems to suggest that little improvement can be expected from the already subdued level.

Sweden (James Smith):

- **Riksbank decision (Wed):** Sweden's Riksbank is poised for its third rate cut since May, marking it out as one of the most dovish developed market central banks this year. In addition to a 25-basis point cut next Wednesday, Governor Thedeen has suggested we could see cuts at the two remaining meetings later this year. That's a message we'd expect to be reiterated this month and we have no reason to doubt that those cuts will be delivered.

Switzerland (Charlotte de Montpellier):

- **SNB rate decision (Thur):** We expect the Swiss National Bank (SNB) to announce a 0.25% rate cut next week. Inflation continues to surprise on the downside, with the government now forecasting 1.2% inflation in 2024 and 0.7% for 2025. The strength of the Swiss franc is posing challenges for exporting companies, which are becoming increasingly vocal on the subject. Some believe this could justify a 50bp rate cut, but we doubt it. With the key rate already at 1.25% since June, the potential for further rate cuts for the SNB is not considerable, and we think it will prefer to cut it to 1%, while at the same time stepping up its intervention in the foreign exchange market.

THINK Ahead in Central and Eastern Europe

Poland (Adam Antoniak):

- **Retail sales (Mon):** We forecast that retail sales increased by 4.0% year-on-year in August, vs. 4.4% in July. Sales growth has moderated slightly in recent months but second-quarter consumption data suggests that demand is shifting towards services (retail sales cover only goods). We expect private consumption growth to ease somewhat through the second half of the year relative to the first half, but it should continue expanding at an annual rate of above 4%. Consumption is still expected to remain the main engine of economic growth in

2024.

- **Construction output (Mon):** We project that construction output fell 8.3% YoY in August, after a 1.3% YoY drop in July. Construction is still in the doldrums and the decline is broad-based. We expect a decline in civil engineering as projects financed by cohesion funds from the new EU budget kick in slowly. Dwelling construction is also subdued. We expect construction to be close to stagnant in 2H24.

- **Unemployment rate (Wed):** The registered unemployment rate is relatively stable and is around all-time lows. We forecast that in August it remained unchanged at 5.0%.

Hungary (Peter Virovacz):

- **NBH rate meeting (Tue):** The Fed's latest jumbo rate cut has opened the door even wider for the National Bank of Hungary to cut its key rate again. We expect a 25bp cut on 24 September, supported by the risk environment, the lower-than-expected August inflation print, and high-frequency activity data which points to sluggish economic growth. As for the forward guidance, while the fundamentals may provide a bit more room on the easing side (and dovish signalling), it may all come down to global risk sentiment and, in practice, the outcome of the US election. So we think the NBH will be very cautious about telegraphing more easing ahead, but may keep the door open for one or two more standard cuts later in the year.
- **Labour market (Mon, Fri):** We expect wage growth to slow only gradually in August, as the tight labour market and public sector wage agreements keep the floor high. On the unemployment front, we see stability, with labour hoarding remaining elevated as companies are reluctant to adjust to weak market demand with layoffs in a labour market where it is difficult to find skilled workers.

Czech Republic (David Havrlant):

- **Consumer confidence (Tue):** Consumer confidence likely deteriorated further in September, as households perceive the economic rebound is advancing at a softer pace than expected. This is even more true of businesses, which face tepid demand from abroad. Germany's weakness has profound implications for the mood of Czech manufacturers.
- **CNB rate meeting (Wed):** Given the risks to economic performance, underperforming industrial output and weaker foreign conditions, there's a growing need for less restrictive monetary policy. However, persistence in services inflation and a pick up in core inflation suggest some caution, which means a 25bp rate cut is the most likely option for the upcoming central bank decision.

Key events in developed markets

Country	Time	Data/event	ING	Prev.
		Monday 23 September		
US	1445	Sep S&P Global Composite PMI Flash	-	54.6
Germany	0830	Sep S&P Global Manufacturing PMI Flash	42.0	42.4
	0830	Sep S&P Global Service PMI Flash	52.0	51.2
	0830	Sep S&P Global Composite PMI Flash	48.2	48.4
UK	0930	Sep S&P Global Composite PMI Flash	53.6	53.8
	0930	Sep S&P Global Manufacturing PMI Flash	52.5	52.5
	0930	Sep S&P Global Services PMI Flash	53.5	53.7
Eurozone	0900	Sep S&P Global Manufacturing PMI Flash	45.1	45.8
	0900	Sep S&P Global Services PMI Flash	52.2	52.9
	0900	Sep S&P Global Composite PMI Flash	50.3	51.0
		Tuesday 24 September		
US	1400	Jul Case-Shiller House Prices (MoM%/YoY%)	-/-	0.6/6.5
	1500	Sep Consumer Confidence	103	103.3
Germany	0900	Sep Ifo Business Climate	86.0	86.6
	0900	Sep Ifo Current Conditions	85.8	86.5
	0900	Sep Ifo Expectations	86.2	86.8
		Wednesday 25 September		
US	1500	Aug New Home Sales (Units mn)	0.715	0.739
Sweden	0830	Riksbank Rate Decision	3.25	3.50
		Thursday 26 September		
US	1330	Aug Durable Goods (MoM%)	-3.5	9.9
	1330	Q2 GDP Final (QoQ%)	-	1.4
Germany	0700	Oct GfK Consumer Confidence	-24	-22
Switzerland	0830	SNB Interest Rate Decision	1.00	1.25
		Friday 27 September		
US	1330	Aug Core PCE Price Index (MoM%)	0.2	0.2
	1330	Aug Personal Spending (MoM%)	0.3	0.5
	1330	Aug Personal Income (MoM%)	0.3	0.3
Germany	0855	Sep Unemployment Rate SA	6.1	6.0
France	0745	Sep HICP (MoM%/YoY%)	-/-	0.6/2.2
Spain	0800	Q2 GDP Final (QoQ%/YoY%)	-/-	0.8/2.5
	0800	Sep CPI (MoM%/YoY%)	-/-	0.0/2.2
Canada	1330	Aug GDP (MoM%)	-	0.0

Source: Refinitiv, ING

Key events in Central and Eastern Europe

Country	Time	Data/event	ING	Prev.
		Monday 23 September		
Kazakhstan	-	Aug GDP (YoY%)	-	4.1
Poland	0900	Aug Retail Sales (YoY%)	4.0	4.4
	0900	Aug Construction Output (YoY%)	-8.3	-1.4
Hungary	730	Jul Average Gross Wages (YoY%)	13	13.3
		Tuesday 24 September		
Turkey	0800	Sep Business Confidence	-	98.5
Poland	0900	Aug Unemployment Rate	5.00	5.00
Hungary	1300	Hungary Base Rate	6.50	6.75
Czech Rep	0800	Consumer Confidence Index	96.7	97.3
		Business Confidence	92.3	93.0
		Consumer & Business Confidence	93.1	93.7
		Wednesday 25 September		
Russia	1700	Aug Industrial Output	1.1	3.3
Hungary	0730	2Q Current Account (m EUR)	1832	1860
Czech Rep	1330	CNB Interest Rate Decision	4.25	4.50
		Thursday 26 September		
Turkey	1200	MPC Meeting Minutes	-	-
		Friday 27 September		
Hungary	0730	Aug Unemployment Rate 3M	4.2	4.2

Source: Refinitiv, ING

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