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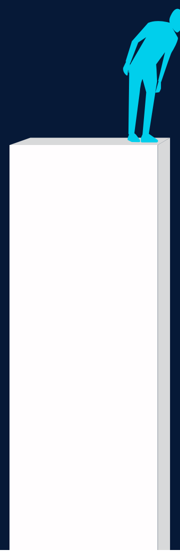

After the Fed pivot, what's next?

From the Field
February 2024

Key Insights

- Reduced expectations that the Federal Reserve will begin cutting interest rates in March have left investors wondering when—and how far—U.S. rates will fall in 2024.
- Based on past Fed hiking and cutting cycles, we expect modest rate cuts, although the Fed's actions will be influenced by inflation and labor market conditions.

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Following the Fed's unexpected pivot away from monetary tightening in December 2023, futures markets aggressively began to price in seven rate cuts in 2024, far exceeding the three cuts of 25 basis points (bps)[1] each projected in the Fed's Summary of Economic Projections.

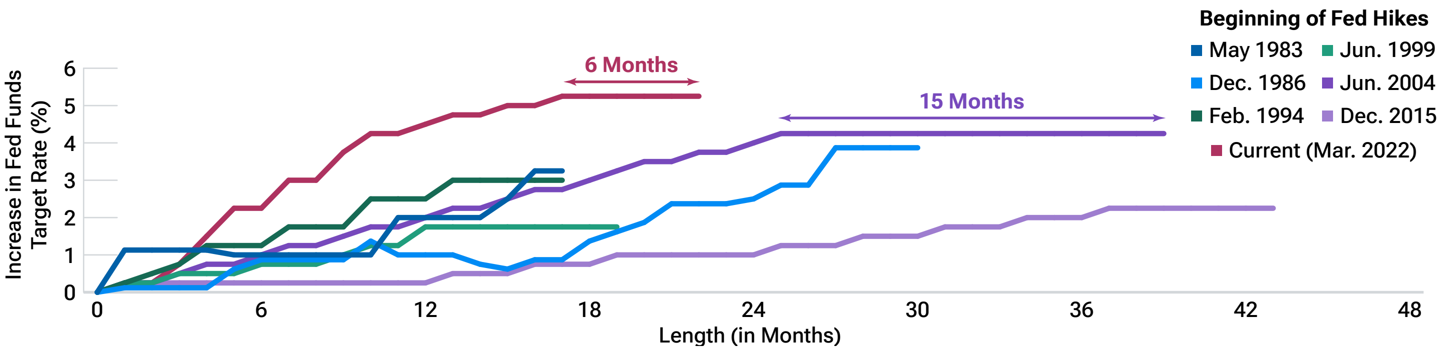
Since then, however, market optimism has cooled, reviving questions about when and how far rates will fall this year.

In the past six Fed hiking cycles since 1980, the first rate cut occurred 6.7 months, on average, after the final rate hike (Figure 1). At the end of 2023, futures markets were pricing in a more than 80% chance of a March rate cut. By January 23, 2024, futures markets were projecting a full cut in May. Since the Fed has been on pause since July 2023, a rate cut in March would be nine months

[1] A basis point equals 1/100th of a percentage point.

When will the Fed start cutting rates?

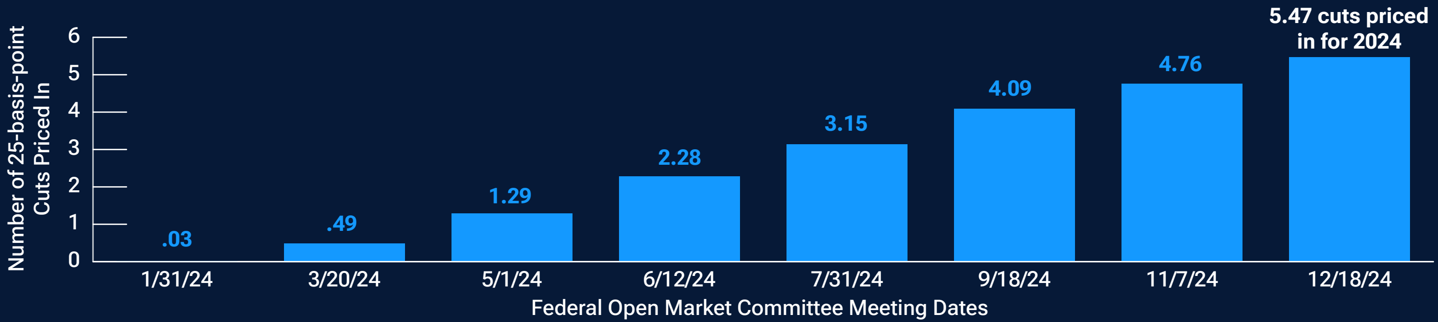
(Fig. 1) Fed hiking cycles



1980 to January 23, 2024.
Past results are not a reliable indicator of future results. Actual outcomes may differ materially from forward estimates.
Source: Bloomberg Finance L.P.

How many Fed cuts in 2024?

(Fig. 2) Cumulative number of rate cuts priced in by Fed funds futures market



As of January 23, 2024.
Actual outcomes may differ materially from forward estimates.
Source: Bloomberg Finance L.P.
A basis point is 1/100th of one percentage point.

after the last hike. Only during the hiking cycle that began in June 2004 was there a longer pause, one which lasted 15 months.

A review of the past seven Fed cutting cycles since 1980 shows that the average rate reduction in the first nine months of each cutting cycle was 2.5%, an equivalent of 10 25-bp cuts. However, these reductions varied widely—from 75 bps to 800 bps—reflecting the varying economic environments.

During five of the past seven cutting cycles, the U.S. economy went into recession. The remaining two cycles—those starting in September 1984 and June 1995—were "soft landings," which provide a better guide in the current economic environment, in our view. In the two soft-landing cycles, rates declined by an average of 23.5% from the peak level. Applied now, the same percentage reduction would lower the federal funds rate target from 5.5% to 4.2%—equaling 5.2 cuts of 25 bps each. Notably, as of January 23, the funds futures market was pricing in a similar outcome, 5.47 cuts in 2024 (Figure 2).

If the U.S. economy remains on track for a soft landing, we expect modest rate cuts in 2024. However, the Fed's actions will depend heavily on inflation and labor market conditions. If inflation heats up, the pace of rate cuts is likely to slow considerably. But if the labor market shows signs of extreme distress, the Fed could speed up cuts to try to avoid a recession.

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