Special Coverage:
US Fed begins the process of monetary policy normalisation

Key takeaways

- The Fed meeting was closely watched, with market expectations split between 0.25% and 0.5%. In the event, the Fed policy normalisation started with a 0.5% cut, moving the rate to 4.75%-5% at its September meeting. The consensus among the Fed officials was that they now foresee two more 0.25% cuts this year, followed by four more cuts next year and two more cuts in 2026.
- The FOMC updated its quarterly projections, with GDP growth expectations nearly unchanged, unemployment projections somewhat higher, and core PCE inflation slightly reduced. We now forecast 0.25% rate cuts at each of the next six policy meetings, taking the federal funds target range down to 3.25%-3.5% by next June.

Jose Rasco
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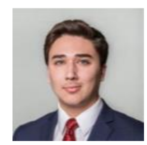

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- Although the market had been anticipating a rate cut, the 0.5% move should provide scope for mild further falls in bond yields. As the Fed expects a soft landing, we continue to prefer quality investment grade over high yield. As the rate cut cycle has now clearly started, holding cash is less attractive. Equity investors should continue to benefit from resilient earnings growth and rate cuts. We thus maintain our overweight on US and global equities.

What happened?

- The FOMC began the process of monetary policy normalisation at its September meeting and cut rates by 0.5% to the target range of 4.75%-5.00%. The FOMC voted 11 to 1 to lower the benchmark for the first rate cut in more than four years.
- The "dot plot" of rate projections shows that the median official expected to lower rates by 1% for the 2024 calendar year, implying two more 0.25% cuts or one larger, 0.5% cut. 9 of 19 officials pencilled in 0.75% of cuts or less. The median rate forecast for 2025 falls to 3.4% from 4.1% (in June), implying four additional 0.25% moves next year.
- At this meeting, the FOMC updated its quarterly projections (published in March, June, September, and December) on real GDP growth, the unemployment rate, inflation, and policy rates. The changes to the economic projections were small, with GDP growth expectations nearly unchanged, unemployment projections somewhat higher, and core PCE inflation slightly reduced.
- Following the September FOMC decision, we now forecast 0.25% rate cuts at each of the next six policy meetings (though another 0.5% "front-loaded" rate cut remains a risk for November), taking the federal funds target range down to 3.25-3.5% by next June.

Median of the FOMC economic projections, September 2024

Variable %	Median				
	2024	2025	2026	2027	Longer run
Change in real GDP	2.0	2.0	2.0	2.0	1.8
June projection	2.1	2.0	2.0		1.8
Unemployment rate	4.4	4.4	4.3	4.2	4.2
June projection	4.0	4.2	4.1		4.2
PCE inflation	2.3	2.1	2.0	2.0	2.0
June projection	2.6	2.3	2.0		2.0
Core PCE inflation	2.6	2.2	2.0	2.0	
June projection	2.8	2.3	2.0		
Memo: Projected appropriate policy path					
Federal funds rate	4.4	3.4	2.9	2.9	2.9
June projection	5.1	4.1	3.1		2.8

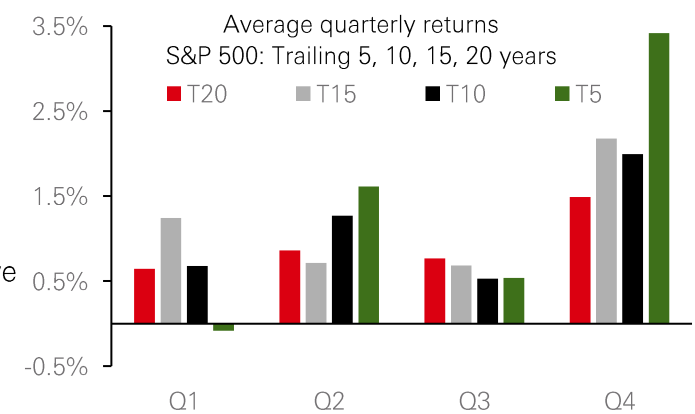
Source: Bloomberg, HSBC Global Private Banking and Wealth as at 18 September 2024.

- At the press conference, Powell said that this rate cut decision "reflects our growing confidence that, with an appropriate recalibration of our policy stance, strength in the labour market can be maintained in a context of moderate growth and inflation moving sustainably down to 2%". In other words, the Fed is expecting that a soft landing of the economy can be achieved.
- Regarding quantitative tightening, Powell mentioned that the Fed also decided to continue to reduce its securities holdings at the same pace. Currently the Fed has a potential balance sheet reduction of up to USD60bn per month: USD25bn for Treasury securities and USD35bn for agency debt and MBS.
- During the Q&A session, Powell was asked "should there be any signal inferred about how the committee would approach and state on the balance sheet policy?" and he responded by saying "we're not thinking about stopping run off" and added "for a time, you can have the balance sheet shrink, but also be cutting rates".
- Powell reiterated that the US labour market is solid and stated that the 4.2% is "a very healthy unemployment rate." When asked about the economy's vulnerability to a shock that could cause a recession, he said "I don't see anything in the economy right now that suggests that the likelihood of a downturn is elevated."
- Recent indicators suggest that economic activity has continued to expand at a solid pace. The Atlanta Fed GDPNow model is currently estimating 2.9% for real GDP growth in the third quarter this year – far from recessionary territory.
- Looking at the economic growth and inflation forecasts from the Fed, it could depict a story of a soft landing. Median estimates are for 2% growth this year and next, while inflation is basically back to target at 2.1% next year and 2% for 2026.
- Powell noted that inflation has come down and the labour market has cooled, but the upside risks to inflation have diminished, and the downside risks to employment have increased. He stated that the risks to achieving the Fed's employment and inflation goals are roughly in balance, and that the Fed is attentive to the risks to both sides of its dual mandate.

Investment implications

- Fixed income investors should continue to look for lower policy and market rates. Fixed income should perform well as policy rates come down and the yield curve re-slopes. They should also keep an eye on quality, investment grade credit, as the business cycle slows and balance sheets could feel stress.
- Equity investors should continue to see upward earnings revisions. Controlled inflation and better productivity should maintain margins and improve profits.
- In addition, as the FOMC's monetary policy easing cycle ensues, it has historically been quite accretive to US corporate profits and equity market returns, which is in keeping with our US equity overweight.

Q4 is historically the best performing quarter for US markets



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 18 September 2024. Past performance is not a reliable indicator of future performance.

- According to FactSet as at 13 September 2024, US corporate earnings are forecast to rise 10.2% in 2024 and 15.4% in 2025. This provides very solid fundamentals for US equity investors.
- Investors should also be aware of seasonal factors. Historically, Q4 has been the best-performing quarter for US equity markets, producing around 40-60% of returns over the last 20 years.

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