ECONOMIC UPDATE

December 18, 2024

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December FOMC Meeting: Inflation Risks Return To The Fore . . .

- The FOMC lowered the Fed funds rate target range by twenty-five basis points, putting the mid-point of the target range at 4.375 percent
- The updated dot plot implies 50 basis points of funds rate cuts by year-end 2025, compared to 100 basis points in the September edition

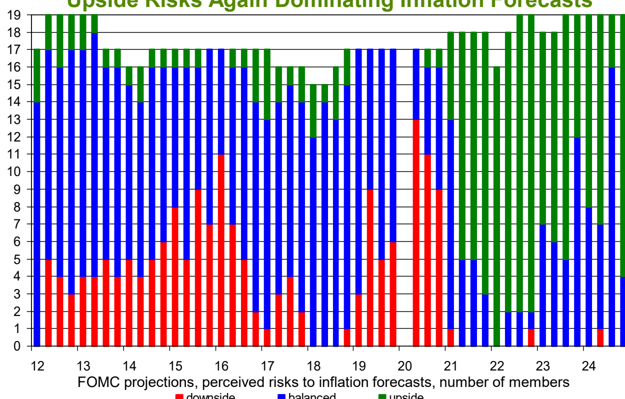
As was widely expected, the FOMC cut the Fed funds rate target range by twenty-five basis points as this week's meeting, lowering the mid-point of the target range to 4.375 percent from the previous mid-point of 4.625 percent. The bigger questions ahead of this week's meeting were the extent of funds rate cuts in 2025 implied by the updated dot plot and the extent to which the median estimate of the neutral funds rate amongst Committee members would increase relative to the September edition of the dot plot. The updated dot plot implies a total of fifty basis points of funds rate cuts in 2025, down from the 100-basis points of cuts implied in the September edition of the dot plot, which is a big step at once for a group perceived to not favor such moves. At the same time, the updated dot plot shows the median estimate of the neutral funds rate to be 3.00 percent, in keeping with the very gradual pace at which this estimate has been going up over the past few meetings. That the updated dot plot implies a slower, shallower path of rate cuts is consistent with the updated economic projections showing a higher expected rate of inflation in 2025, which could reflect concerns over inflation proving to be more persistent than anticipated but which could also reflect the perception that the mix of policy changes expected to be sought by the incoming administration could be at least somewhat inflationary, on net. There was one dissenting vote against today's rate cut, cast by Cleveland Fed President Hammack, the first dissenting vote by a regional president since June 2022.

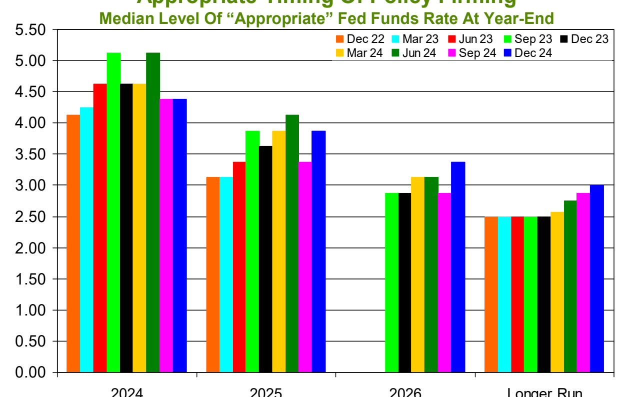
The post-meeting policy statement is virtually the same as that issued in November, the one change being the use of the phrase "in considering the extent and timing of additional adjustments to the target range," whereas the November statement used "in considering additional adjustments . . ." This change can be seen as suggesting the Committee remaining on hold in January as they await incoming economic data and details on changes to fiscal, trade, regulatory, and immigration policy.

The updated economic forecasts put expected real GDP growth, on a Q4/Q4 basis, at 2.5 percent in 2024, up from 2.0 percent in the September projections, but there was only a modest change – from 2.0 percent to 2.1 percent – in the projection for real GDP growth in 2025 (Q4/Q4). More noteworthy, the forecasts for total and core inflation in 2024 and 2025 are higher than in the September projections. The expected rate of core PCE inflation in Q4 2024 is now pegged at 2.8 percent, up from 2.6 percent, while the expected Q4 2025 rate moved up to 2.5 percent from 2.2 percent. Chair Powell noted that some Committee members made some allowances for anticipated policy changes in their forecast while others took a wait-and-see approach. What really stands out, however, is the shift in how Committee members perceive the risks to their inflation forecasts. Recall that in September, sixteen of the nineteen members saw the risks to their inflation forecasts as being broadly balanced, the most in the history of the projections. This month, however, fifteen members see the risks to their inflation forecasts as being weighted to the upside. This is one means of members allowing for inflationary impacts of policy changes without formally injecting them into their forecasts.

The shift in the median year-end 2025 dot is consistent with the higher inflation forecast and the risks to that forecast being seen as weighted to the upside. It is worth noting that the dot plot shows four members did not think today's rate cut to be appropriate, though we know only one of those members – Cleveland Fed President Hammack – is a voting member this year. The small increase in the estimate of the neutral funds rate could be a sign that members expect inflation to be more persistent, or it could be that they are, albeit grudgingly, allowing for the recent upturn in productivity growth to be sustained. Either way, on this basis, policy still remains restrictive, thus allowing for at least a moderate path of rate cuts from here, as implied in the updated dot plot.

At this point, no one should take any edition of the dot plot as being even remotely set in stone, especially this one. In his post-meeting press conference, Chair Powell pointed to the downside risks in the labor market as one factor weighing into the FOMC's deliberations, as though market participants have lost track of the clear cooling in labor market conditions. Chair Powell went so far as to say that "we do not need further cooling" in the labor market to bring about a further reduction in inflation. Still, given the uncertain policy landscape, Chair Powell's confidence that inflation is "broadly on track" back to the FOMC's 2.0 percent target will be put to the test, likely sooner rather than later.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com