GLOBAL MARKETS RESEARCH

Interest Rates Focus

9 September 2024

Our Latest Fed Funds Rate Expectation

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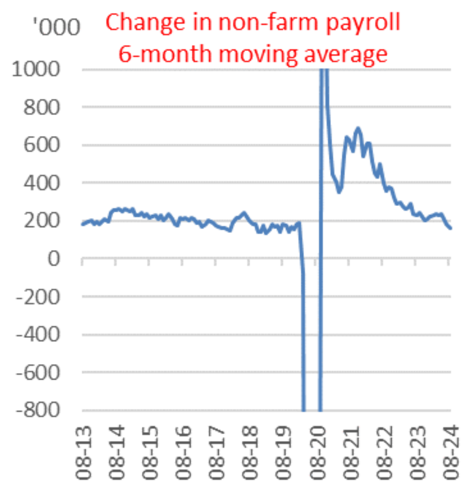
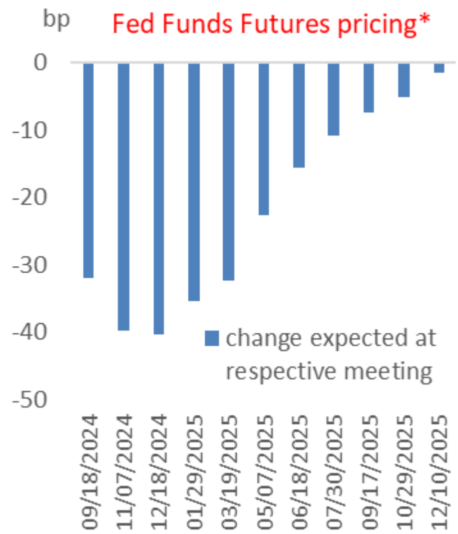
- The UST curve steepened on Friday upon payrolls and other labour market statistics releases. After some intra-day fluctuations, Fed funds futures last priced around a 28% chance of a 50bp cut next week and a total of 112bps of cuts by year-end, which was similar to the pricing before payrolls; 2025 pricings were little changed, with Fed funds futures last pricing a total of around 130bps of rate cuts in 2025, as markets had already been dovish running into payrolls. The intra-day whipsawing in US yields reflected perceived uncertainty as to how the US economy will ultimately land, as the August labour market outcome was inconclusive. **Our base case remains for a 25bp Fed funds rate cut at the September FOMC, but we are adding one 25bp rate cut back to our expected profile for this year, now expecting 75bps of cuts by year-end**, with a 25bp cut expected at each of the meetings in September, November, and December. **We maintain our expectation for 125bps of cuts for 2025**. If these expected rate cuts materialise, then the Fed funds rate will be brought to a range of 3.25-3.50% by end-2025, which shall be near the neutral level or in itself represents a neutral level.

- August payrolls and labour market statistics did not end the debate among market participants on growth moderation versus growth deterioration, but **the FOMC would probably not characterise the growth outlook as deteriorating at this juncture**. Waller opined that "the August report along with other recent labor data tend to confirm that there has been a continued moderation in the labor market"; the August "jobs report continues the longer-term pattern of a softening of the labor market that is consistent with moderate growth in economic activity"; "while the labor market has clearly cooled, based on the evidence [he] see[s], [he does] not believe the economy is in a recession or necessarily headed for one soon". Meanwhile, Williams commented officials can move policy "towards neutral over time depending on the evolution of the data", and "there is not a general principal of you should be gradual, or you should move fast". **Some FOMC officials appears open to bigger-sized cuts and/or back-to-back cuts but it is all data-dependent** and thus far the data do not provide a strong justification for a 50bp cut to start with. We however expect there will be some discussions about bigger rate cuts at the upcoming meeting, primarily to maintain policy optionality instead of representing a particular policy rate decision or any policy commitment.



Source: Bloomberg, OCBC Research



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- **US labour market conditions**. August payrolls printed soft at 142K compared to expectation of 165K but were nevertheless higher than each of the previous two months (after downward revisions). Six-month average of payrolls (up to August) was 164K, which argues for reducing the restrictiveness of monetary policy. On the other hand, the household survey showed unemployment rate was little changed at 4.2% (4.22% versus July's 4.25%), so was average weekly hours. This latest labour market report in itself is not sufficiently weak enough to immediately warrant a 50bp rate cut at the upcoming September FOMC in our view, but it is not strong enough to throw it out of the window from market's perspective. This week's CPI print is the next key focus since the Fed officials have entered a blackout period ahead of the September FOMC meeting. Data dependency comes with risks, which may potentially sustain market speculation that the Fed is possibly behind the curve. A soft-landing scenario for the US economy may also be viewed with greater scepticism with each set of incoming dovish economic data releases.

Rates Forecast

USD Interest Rates	Q324	Q424	Q125	Q225	Q325	Q425
FFTR upper	5.25	4.75	4.25	4.00	3.75	3.50
SOFR	5.08	4.58	4.08	3.85	3.60	3.35
3M SOFR OIS	4.85	4.45	4.05	3.90	3.65	3.40

Source: OCBC Research

Macro Research

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