1 August 2024

US Federal Reserve: On the finish line

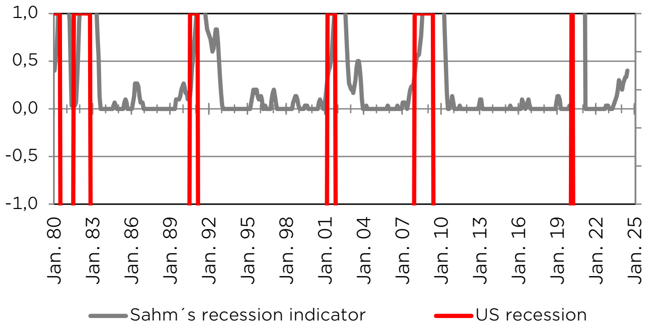
The time has come: although the US Federal Reserve has left interest rates unchanged, it has left the door wide open for a rate cut at its next meeting on September 18. At the press conference following the FOMC meeting, Fed Chairman Powell naturally kept his cards close to his chest and emphasized once again that the central bank would decide on the basis of the data available at that time. However, he also said that the time for a key interest rate cut had come closer. "A key interest rate cut at the next meeting in September is on the table." Although a rate cut in July had been discussed, there was ultimately a consensus among all those involved to wait a little longer, as inflation had not yet reached its target.

In our view, the time has long since come to cut interest rates. In view of the significant fall in the inflation rate, the real key interest rate, which best reflects how expansive or restrictive monetary policy is, is at such a high level that has almost always led to a recession in the past. In addition, a look at the Fed's economic projections published in June shows that the unemployment rate is currently slightly higher and the inflation rate slightly lower than expected for the end of the year. We expect inflation to fall slightly in the coming months and the unemployment rate to rise slightly.

Greater focus on the labor market

The fact that the Fed is moving closer to easing its monetary policy can also be seen from the central bank's statement on yesterday's decision. Two important changes were made compared to the last time: Firstly, inflation was now only described as "slightly elevated", a much more moderate assessment than before. Secondly, the assessment of the development of the US labor market was less positive than before. As the Fed has a dual mandate, the focus has shifted: the inflation risks, which argue for a more restrictive monetary policy, now play a lesser role, while the risks of an undesirable weakening of the labor market, which require a more expansive monetary policy, are more important. From a capital market perspective, the next labor market data will therefore become more important, as Powell has made it clear that the central bank does not want to see a further cooling of the labor market.

US labor market: Sahm's recession indicator



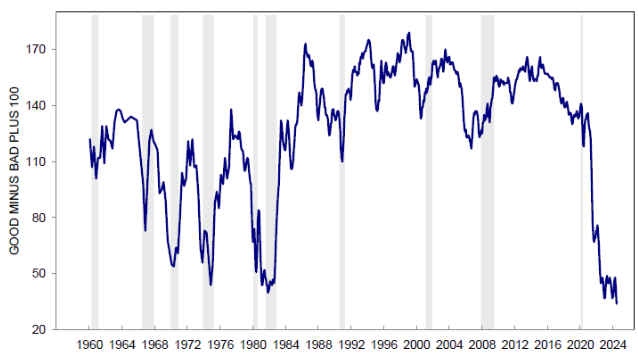
source: Refinitiv Datastream

Unemployment has risen slightly in recent months, from a low of 5.7 million to 6.8 million most recently. At 4.1 percent, the unemployment rate in the USA is still at a very low level; the average since the 1970s has been just over six percent. Nevertheless, many people are looking at a recession indicator developed by US economist Claudia Sahm, known as the Sahm Rule. This rule of thumb identifies signals for the start of a recession when the three-month moving average of the national unemployment rate rises by half a percentage point or more compared to the lowest point of the previous twelve months. According to our calculations, in the past this value was at least 0.53 percentage points before the start of a recession. Even if this rule is not a law of nature, it has strong empirical evidence: every US recession could be recognized with its help. Currently, the three-month average of the unemployment rate is 0.43 percentage points above the lowest point of the last 12 months. If the unemployment rate in July, which will be published on Friday, rises from 4.1 to 4.3 percent, the threshold of 0.5 percent would be reached. However, the unemployment rate is expected to remain unchanged.

Trouble with politicians inevitable, but not relevant to decision-making

If the US Federal Reserve cuts interest rates in September, it will inevitably be drawn into the US presidential election campaign. Whatever it decides, criticism from one political camp or another is certain. If interest rates are cut, Donald Trump will be annoyed by the central bank's supposed election campaign aid for the Democrats; if monetary policy remains as it is, the Democrats will complain because high interest rates will depress voter sentiment as the purchase of expensive goods such as cars or real estate will become even more expensive.

CHART 41: BUYING CONDITIONS FOR HOUSES



source: Uni Michigan Consumer Sentiment, June Data Booklet

However, changes in monetary policy always have a delayed effect on the economy. The winner of an election, be it Kamal Harris or Donald Trump, will therefore always benefit from an interest rate cut. In this respect, it makes no sense for the Fed to postpone an interest rate decision until after the election. This is exactly what Fed Chairman Powell emphasized yesterday. The central bank bases its decisions exclusively on economic circumstances and necessities. Cutting interest rates too early could fuel inflation again, while cutting them too late could plunge the US economy into recession. It is precisely these two aspects that the central bank has to weigh up against each other.

Provided that the economic data situation allows it, a rate cut in September would not undermine the credibility of the central bank. On the contrary, this would be the case if it were to back down and not cut interest rates. If Donald Trump wins the presidential election, the Fed could, for example, show how serious it is about reducing interest rates by quickly cutting rates again at the next FOMC meeting on November 7, which takes place exactly one day after the election. This is exactly what the majority of market participants are expecting, as a look at Fed funds futures shows.

	CME FEDWATCH TOOL - CONDITIONAL MEETING PROBABILITIES								
MEETING DATE	300-325	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525
18.09.2024					0,0%	0,0%	0,0%	13,5%	86,5%
07.11.2024	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	9,7%	65,8%	24,5%
18.12.2024	0,0%	0,0%	0,0%	0,0%	0,3%	11,2%	64,7%	23,9%	0,0%
29.01.2025	0,0%	0,0%	0,0%	0,2%	8,9%	53,8%	32,2%	4,8%	0,0%
19.03.2025	0,0%	0,0%	0,2%	8,2%	50,2%	33,9%	7,1%	0,4%	0,0%
30.04.2025	0,0%	0,1%	5,4%	35,6%	39,6%	16,4%	2,7%	0,1%	0,0%
18.06.2025	0,1%	3,9%	27,1%	38,5%	22,9%	6,6%	0,9%	0,0%	0,0%
30.07.2025	1,9%	14,6%	32,3%	31,3%	15,4%	3,9%	0,5%	0,0%	0,0%

source: CME FedWatch, August 1, 2024, 12:30 p.m.

A look at the past shows that the Fed has often adjusted its monetary policy in the run-up to presidential elections in the past. In 2020, the Fed decided to loosen monetary policy due to the coronavirus pandemic by launching an extensive bond-buying program to stimulate the economy. In 2012, monetary policy was also loosened in September shortly before the elections with a bond-buying program. In 2008, the Fed lowered the key interest rate throughout the year due to the economic and financial crisis. In 2004, interest rates were raised because the economy had made a sustained recovery after the long period of weakness in 2000 and 2003. In 2000, monetary policy also became increasingly restrictive over the course of the year until the summer. So it was always done what had to be done: this is exactly what characterizes an independent central bank.

Carsten Klude

Market data

Stock marktes	As of 01.08.2024 15:45	Change versus 25.07.2024 -1 week	28.06.2024 -1 month	30.04.2024 -3 months	31.07.2023 -1 year	29.12.2023 YTD
Dow Jones	40993	2,6%	4,8%	8,4%	15,3%	8,8%
S&P 500	5587	3,5%	2,3%	11,0%	21,8%	17,1%
Nasdaq	17599	2,4%	-0,8%	12,4%	22,7%	17,2%
DAX	18304	0,0%	0,4%	2,1%	11,3%	9,3%
MDAX	25271	1,3%	0,4%	-3,8%	-12,4%	-6,9%
TecDAX	3343	1,3%	0,5%	2,1%	0,4%	0,2%
EuroStoxx 50	4828	0,3%	-1,3%	-1,9%	8,0%	6,8%
Stoxx 50	4472	1,4%	-0,4%	1,8%	10,3%	9,3%
SMI (Swiss Market Index)	12317	1,8%	2,7%	9,4%	8,9%	10,6%
Nikkei 225	38126	0,7%	-3,7%	-0,7%	14,9%	13,9%
Brasilien BOVESPA	128511	2,0%	3,7%	2,1%	5,4%	-4,2%
Indien BSE 30	81868	2,3%	3,6%	9,9%	23,1%	13,3%
China CSI 300	3419	0,6%	-1,2%	-5,1%	-14,8%	-0,3%
MSCI Welt	3572	2,3%	1,7%	8,1%	16,6%	12,7%
MSCI Emerging Markets	1085	1,0%	-0,1%	3,7%	3,6%	6,0%
Bond markets						
Bund-Future	133,73	109	211	365	73	-349
Bobl-Future	117,69	70	125	126	180	-159
Schatz-Future	106,13	20	42	102	108	-42
3 Monats Euribor	3,65	-2	-1	-24	-7	-24
3M Euribor Future, Dec 2024	3,11	-6	-19	-21	-10	81
3 Monats $ Libor	5,50	-2	-8	-9	-12	-9
Fed Funds Future, Dec 2024	4,74	-6	-25	-36	47	91
10 year US Treasuries	4,01	-24	-36	-67	6	14
10 year Bunds	2,27	-9	-19	-29	-20	27
10 year JGB	1,03	-1	0	19	45	41
10 year Swiss Government	0,45	-8	-9	-30	-54	-25
US Treas 10Y Performance	606,14	1,6%	2,9%	6,2%	3,0%	0,9%
Bund 10Y Performance	562,46	0,9%	1,9%	3,2%	4,3%	-0,5%
REX Performance Index	448,93	0,7%	1,2%	2,2%	3,7%	0,2%
IBOXX AA, €	3,18	-10	-28	-32	-45	12
IBOXX BBB, €	3,70	-10	-32	-38	-76	-5
ML US High Yield	7,79	-1	-23	-53	-62	0
Commodities						
MG Base Metal Index	403,04	1,4%	-6,6%	-9,6%	1,4%	3,1%
Crude oil Brent	81,38	-0,4%	-5,8%	-7,4%	-4,9%	4,7%
Gold	2451,83	3,6%	5,4%	6,8%	24,6%	18,7%
Silver	28,82	3,2%	-1,6%	9,1%	16,2%	18,8%
Aluminium	2228,01	0,6%	-10,4%	-13,8%	-0,7%	-5,0%
Copper	9102,28	1,1%	-3,7%	-8,0%	3,4%	7,5%
Iron ore	100,10	-6,6%	-6,0%	-9,7%	-11,0%	-26,6%
Freight rates Baltic Dry Index	1708	-6,9%	-16,7%	1,4%	51,6%	-18,4%
Currencies						
EUR/ USD	1,0800	-0,5%	0,9%	0,8%	-2,0%	-2,3%
EUR/ GBP	0,8427	0,0%	-0,6%	-1,3%	-1,7%	-2,8%
EUR/ JPY	162,65	-1,8%	-5,4%	-3,3%	3,8%	4,0%
EUR/ CHF	0,9459	-0,8%	-1,8%	-3,4%	-1,7%	2,1%
USD/ CNY	7,2455	0,1%	-0,3%	0,0%	1,4%	2,0%
USD/ JPY	149,99	-2,6%	-6,8%	-5,0%	5,4%	6,3%
USD/ GBP	0,78	0,5%	-1,3%	-2,3%	0,4%	-0,5%

Source: Refinitiv Datastream

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