Economic Research Unit

Economics Weekly

Bank of Ireland

Fed to begin rate-cutting cycle in September

Last Friday's weaker than expected employment report in the US prompted fears of an impending recession and sparked a dramatic reaction in financial markets, with bond yields plunging, stocks selling off sharply and the dollar weakening. While these moves have been substantially reversed since, the market sees the Fed kicking off what is expected to be the start of a sustained rate-cutting cycle at its September meeting. The ECB is also expected to cut rates next month, while the Bank of England (BoE) is seen following up this month's quarter-point cut with another 25bps move by November at the latest.

Modest job gains and rising unemployment in July: The US economy added 114k jobs in July, well below the 175k increase expected and the smallest gain in 2024 so far, and the unemployment rate rose for a fourth month in a row to 4.3%, its highest level since late 2021, while wage growth slowed further. Though employment still rose by a relatively healthy 170k a month over the three months to July, the pace of jobs growth is slowing and labour demand is cooling, as reflected in a steady decline in job openings in the economy. This is consistent with a moderation in the pace of economic growth over the first half of this year, with GDP increasing by an average of 0.5% a quarter over the first two quarters of 2024, down from more than 1% a quarter over the final two quarters of 2023.

Fed stayed on hold in July but flagged September rate cut: A couple of days before Friday's employment data, the Fed concluded its latest monetary policy meeting. It left interest rates unchanged (at 5.25%-5.5%) but indicated a rate cut was likely in September, saying it is "attentive" to the risks to both inflation and employment, a significant change from its June meeting when it stated it remained "highly attentive" to the risk of persistently high inflation. This copper-fastened market expectations for a 25bps cut in September, while some chance of a 50bps move is now priced in following the soft jobs data and the bout of volatility in financial markets. In any case, with growth moderating, the labour market softening, and inflation having resumed its decline, this is seen as the start of a sustained fall in rates, amounting to almost 200bps over the next twelve months or so.

ECB to cut again in September: Having lowered the deposit rate to 3.75% in June, the ECB remained on hold in July and didn't give much away about what it might do at its next meeting in September. While underlying inflation has been sticky recently, the ECB's updated projections next month are likely to again show inflation returning to the 2% target over the second half of 2025 and into 2026, which will be the cue for it to lower rates again. Looking beyond next month, the market expects the ECB to cut rates steadily over the coming quarters, by some 150bps by September next year. The BoE, meanwhile, is expected to follow up this month's quarter-point cut (to 5%) with another 25bps reduction by November at the latest, and to lower rates by 125bps over the next year. Market expectations are volatile, of course, but with inflation substantially lower and close to target, the direction of travel for central bank rates seems clear.

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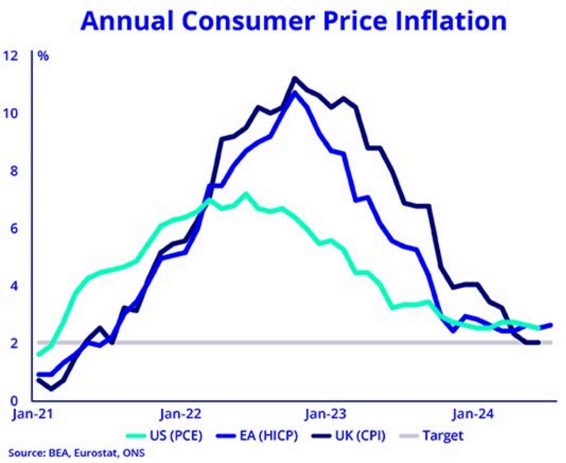

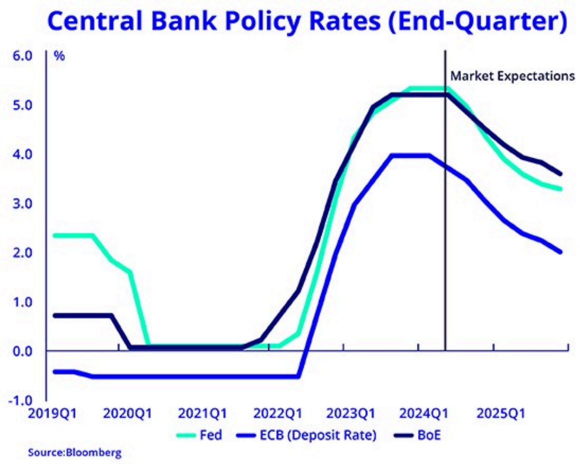

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