



Market Watch

Fed flags slower pace of rate cuts

Summary

The US Federal Reserve cut its benchmark interest rate by 25bps to 4.5%, as expected. This is the third rate cut in this cycle after the US central bank started easing its policy rate from a 23-year high of 5.5% in September to support growth.

However, the Fed projected a slower pace of rate cuts going forward, compared with its September projections, as disinflation stalled and amid uncertainty around fiscal policies. It now expects 50bps of rate cuts each in 2025 and 2026. It also raised its growth estimates for 2024-25 and inflation estimates for 2024-26.

The S&P500 index slumped 2.9%, recording its biggest decline since August. The 10-year US government bond yield jumped 11bps to a six-month high of 4.51%, the USD index (DXY) surged 1% to a 2-year high, while gold fell 2.3% from the previous day's close.

We expect further Fed rate cuts and Trump's proposed tax cuts and deregulation to sustain US growth and earnings outperformance over the next 6-12 months. Hence, we would use the pullbacks to add to US equities and High Yield bonds. A revival of inflation is a key risk, which we mitigate via an Overweight in gold.

Background

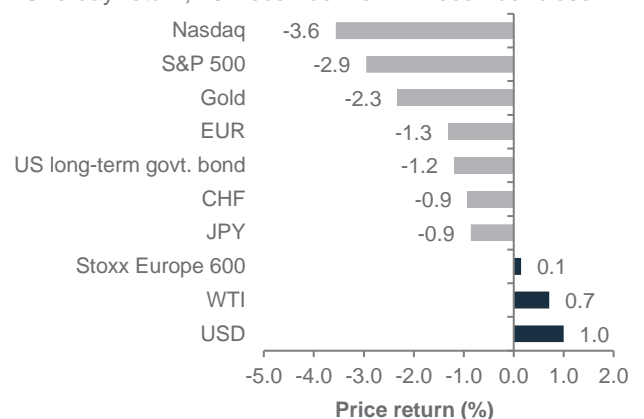
Resilient growth and still-elevated inflation explains Fed caution. The Fed's revised projections, which indicate a slower pace of rate cuts next year, follow data showing resilience in US growth and the job market. The Atlanta Fed GDPNow projects 3.2% annualized GDP growth in Q4, following 2.8% growth in Q3. Meanwhile, the economy generated an average 143,000 net new jobs in the past six months, leaving the jobless rate close to the Fed's long-run target. Moreover, US disinflation has stalled in recent months, leaving annualized core inflation at 3.3%, well above the Fed's 2% target.

Policy uncertainty under Trump. Fed Chair Powell said that, after the rate cuts, monetary policy stance "is now significantly less restrictive" and policymakers "need to take our time, not rush and make a very careful assessment" of the incoming administration's policies. The scope of Trump's proposed tariffs and tax cut plans and immigration policies will likely impact growth and inflation outlook.

Market-friendly administration? Trump's nomination of Wall Street veteran Scott Bessent as Treasury Secretary leads us to believe that the incoming administration will aim for non-inflationary growth and will be sensitive to feedback from markets. Such a scenario should sustain the disinflation trend, enabling the Fed to cut rates by another 75bps in 2025. Whether the administration imposes tariffs in phases as a negotiating tool and the scope of tax cuts and deregulation policies will be a key focus for markets in the coming months.

Equities, bonds and gold fell, while the USD rose after the Fed signalled a slower pace of rate cuts

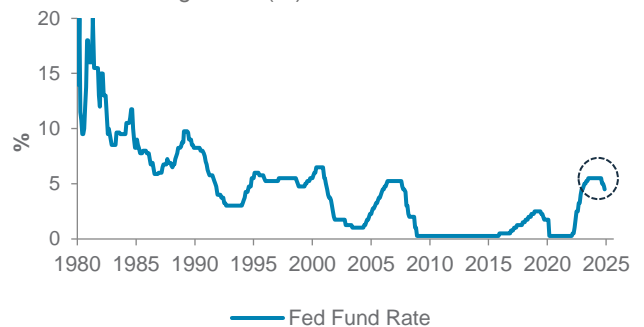
One-day return, 18 December vs. 17 December close



Source: Bloomberg, Standard Chartered

The Fed's 25bps rate cut is the third reduction in the current policy easing cycle

Fed funds target rate (%)



Source: Bloomberg, Standard Chartered

The Fed projected a slower pace of rate cuts and lifted growth and inflation estimates

The Fed's December projections vs. its September estimates

	GDP		Unemployment		Core PCE		Rates estimates	
Dates	Old	New	Old	New	Old	New	Old	New
2024	2.0	2.5	4.4	4.2	2.6	2.8	4.4	4.4
2025	2.0	2.1	4.4	4.3	2.2	2.5	3.4	3.9
2026	2.0	2.0	4.3	4.3	2.0	2.2	2.9	3.4
LR*	1.8	1.8	4.2	4.2			2.9	3.0

Source: Bloomberg, Standard Chartered

What does this mean for investors?

Equities

Buy on dips. Following the sell-off last night, US equities could consolidate further with the Fed signalling a slower path for rate cuts, but the Fed's plan to continue with rate cuts is positive for US equities. We would use this opportunity to add exposure, given that we expect earnings growth to accelerate in 2025, driving US equities higher longer term. We see near-term support at 5,860, followed by 5,674. Our 12-month target for the S&P500 index is 6,650.

Our opportunistic buy ideas in the US are (i) technology and (ii) communication services sectors, (iii) major banks and (iv) regional banks, as well as (v) small caps. Strong economic growth benefits these sectors, especially the small caps which are more domestically focused. Small caps also tend to hold more floating rate debt, benefitting directly from lower rates. The continuing developments in AI support growth for the technology and communication sectors. Valuations of these growth sectors also benefit from lower rates, which discount future cashflows more lightly. Major and regional banks face less net interest margin headwind with slower rate cuts. Furthermore, we expect sustained growth to offset interest margin pressures, and deregulation under the incoming Trump administration will be a powerful tailwind for the banks.

Bonds

Lock in elevated yields. We believe the jump in bond yields after the Fed meeting has made it more attractive to lock in the yields to earn long term income. After the Fed decision, the benchmark 10-year government bond yield closed at 4.51%, breaking above the key 4.47% resistance. Markets continue to expect the Fed to cut the benchmark rate to 4.00% (-50bps) by December 2025.

Over the next 6–12 months, we anticipate Fed cuts will continue guiding the economy toward a soft landing, especially if it is further supported by growth-supportive policies from the Trump administration. While sticky inflation is a risk, we view current market inflation expectations as excessive. We expect the 10-year US government bond yield to drift lower to 4.00-4.25% by December 2025 as market expectations of Fed cuts converge towards our expectation of 75bps (vs. current market expectations of 50bps).

In this context, we would take advantage of current yield levels to lock in income for the long term. We continue to view Developed Market (DM) Investment Grade government bonds as core holdings and believe an Overweight is warranted for DM High Yield bonds on the back of strong growth and limited credit risk.

FX

Rangebound USD. We see the rates outlook supporting a rangebound USD. A rate cut typically weakens the USD as lower rates make the currency less attractive. However, the Fed's signaling of a cautious approach to further easing is likely to limit losses.

Technically, the USD index (DXY) is overbought but the momentum indicator (MACD) suggests modest upward pressure to continue. A firm break above 108.2 could pave the way for a test of the next resistance at 109. However, beyond this horizon we expect the index to stay rangebound over the next 1-3 months. Longer term, the focus is likely to shift back to US fiscal and trade policies and Euro area rates, supporting a rangebound USD.

We expect a pickup in earnings growth in 2025 to drive US equities higher

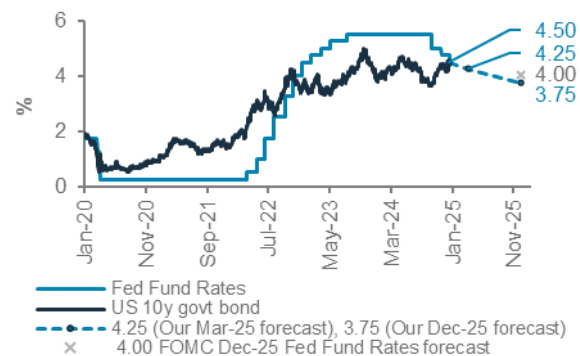
Consensus quarterly earnings growth y/y for S&P500 index



Source: LSEG I/B/E/S, Standard Chartered

We expect a re-pricing of rate cut expectations to drive bond yields lower in the coming months

US 10-year government bond yield, Fed Fund rates and our forecast



Source: Bloomberg, Standard Chartered

Fed's slower pace of rate cuts points to a moderate downside risk to real rates and the USD

USD index (DXY) and US inflation-adjusted (real) yield



Source: Bloomberg, Standard Chartered

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