

December 12, 2024, Fed Funds Rate Expected to Hit 3.75% by Year-End 2025

Institutional Only

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Key Discussion Points:

- Excuse me if you've heard this before, but the resilience of the consumer continues to fool forecasters. Despite trying to give the consumer renewed benefit of the doubt, we still missed to the downside on GDP. Third quarter GDP, after the second estimate, was an impressive 2.8% vs. our third quarter GDP forecast of 1.5%. With that brow-beating fresh in mind, we have fourth quarter GDP logging in at an impressive 3.0% then moderating back to 2.0% in the first quarter of 2025 before dipping slightly to 1.8% for two quarters before trending back to 2.0% by year end. Like our previous forecasts, we see the economy avoiding a recession, but the soft-landing scenario into a buzzing of the tower, at least in 2025.
- The second quarter's cooler inflation numbers were matched by similar readings in the third quarter with the overall monthly rate printing 0.2% four of the last five months. Core CPI has been stuck at 0.3% for four straight months which takes us to the next topic. We continue to believe that getting to the Fed's 2% target will be tough in 2025 with monthly numbers seemingly stuck at 0.2% to 0.3%. Furthermore, with the incoming Trump Administration, and the inflation-inducing proposals, we have dialed back our expectations on inflation improvement. In the September forecast we foresaw reaching the 2% target by mid-year. Now we don't see hitting the 2.0% target for another year, second quarter 2026. That has us reducing our expected rate cuts in 2024 from four to three with the year-end 2025 funds rate at 3.75%.
- The 10yr Treasury started the fourth quarter at 3.78% and rose to a quarterly high of 4.45% in the aftermath of the presidential election. That is still below the YTD high of 4.71% back in April and is currently down in the 4.15%-4.30% range as a December rate cut looks like a fait accompli. Unlike our earlier forecasts, where we thought the cumulative impact of rate hikes would eventually slow the economy, with inflation begrudgingly declining, now that rate cuts have begun, we see growth and inflation hanging in there more stubbornly. Thus, we see 10yr yields down only to the 4.25% - 4.35% area by year-end. We see the yield ranging between 4.00% and 4.50% in 2025, perhaps drifting to 4.50% by mid-year as those inflation-inducing policies are introduced. Then the higher yield will act as a modest brake on economic growth with the yield trending back towards 4.00% by year-end 2025. However, we see that 4.00% level as close to the bottom as growth starts to rebound as the cumulative rate cuts work through the economy and spur more growth.
- After exhibiting surprising resilience in the face of 525bps in rate hikes, the labor market saw a noticeable slowing in momentum during the summer. That slowing stabilized in the third quarter. October was weak but noisy with hurricanes and strikes clouding the true picture. We expect job gains to remain in the 150 thousand area per month in the fourth quarter and dipping to 125 thousand in the first quarter of 2025. The second quarter is expected to rebound slightly to 150 thousand and back to 175 thousand by year end 2025.
- We have unemployment peaking at 4.4% in the first and second quarters of 2025. Then the rate cuts, tax cut extensions, and deregulatory policies from the new administration will aid growth in the second half of 2025 with the unemployment rate falling to 4.2% by year-end 2025 and down to 3.9% by mid-2026.

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ECONOMIC FORECAST



Economic Indicators	2024				2025				2026		Annual Average		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	2024	2025	2026
Interest rates													
Federal funds rate (top target)	5.50%	5.50%	5.00%	4.50%	4.50%	4.25%	4.00%	3.75%	3.50%	3.50%	5.1%	4.1%	3.5%
3-mo Treasury Bills	5.37%	5.35%	5.00%	4.25%	4.25%	4.00%	3.75%	3.50%	3.25%	3.25%	5.0%	3.9%	3.3%
2-yr Treasury Notes	4.62%	4.75%	3.64%	4.00%	4.00%	3.75%	3.25%	3.00%	2.75%	2.75%	4.3%	3.5%	2.8%
5-yr Treasury Notes	4.21%	4.37%	3.56%	4.10%	4.00%	3.75%	3.25%	3.00%	2.75%	2.75%	4.1%	3.5%	2.8%
10-yr Treasury Notes	4.26%	4.40%	3.78%	4.30%	4.50%	4.50%	4.25%	4.00%	4.25%	4.25%	4.2%	4.3%	4.3%
30-yr Treasury Bonds	4.40%	4.56%	4.12%	4.45%	4.65%	4.75%	4.50%	4.25%	4.50%	4.50%	4.4%	4.5%	4.5%
Prime Rate	8.50%	8.50%	8.00%	7.50%	7.50%	7.25%	7.00%	6.75%	6.50%	6.50%	8.1%	7.1%	6.5%
Avg.30Yr Fixed Rate Mortgage	7.25%	7.25%	6.68%	7.00%	7.50%	7.50%	7.25%	7.00%	7.25%	7.25%	7.0%	7.3%	7.3%
GDP (QoQ% SAAR)													
Consumer Spending	1.5%	2.9%	3.5%	2.5%	2.0%	2.3%	2.0%	2.5%	2.5%	2.5%	2.6%	2.2%	2.5%
Government Spending	1.8%	2.7%	5.0%	2.5%	2.5%	2.3%	2.5%	2.0%	2.0%	2.0%	3.0%	2.3%	2.0%
Private Investment	4.4%	7.5%	1.1%	2.0%	2.3%	2.3%	2.5%	2.8%	3.0%	3.5%	3.8%	2.4%	3.3%
Exports	1.6%	1.6%	7.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	3.3%	2.5%	2.5%
Imports	6.1%	7.0%	10.2%	5.0%	4.0%	2.5%	2.5%	2.5%	2.5%	2.5%	7.1%	2.9%	2.5%
Inflation Indicators													
CPI (YoY%)	3.5%	3.2%	2.6%	2.7%	2.5%	2.3%	2.3%	2.3%	2.2%	2.0%	3.0%	2.3%	2.1%
Core CPI (YoY%)	3.8%	3.3%	3.3%	3.3%	3.2%	3.0%	2.8%	2.5%	2.3%	2.3%	3.4%	2.9%	2.3%
PCE (YoY%)	2.7%	2.6%	2.3%	2.4%	2.5%	2.5%	2.3%	2.3%	2.1%	2.0%	2.5%	2.4%	2.1%
Core PCE (YoY%)	2.8%	2.7%	2.7%	2.9%	3.0%	3.0%	2.8%	2.5%	2.3%	2.2%	2.8%	2.8%	2.2%
Labor Market													
Unemployment Rate	4.0%	4.0%	4.2%	4.3%	4.4%	4.4%	4.3%	4.2%	4.1%	3.9%	4.1%	4.3%	4.0%
Non Farm Payrolls (000s) (Avg. per month)	267	147	159	150	125	150	150	175	175	200	181	150	188
Avg. Hourly Earnings (YoY%)	4.1%	4.0%	4.0%	4.0%	3.8%	3.5%	3.8%	3.8%	3.8%	4.0%	4.0%	3.7%	3.9%

Actuals in blue font

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