

Special Coverage: FOMC: Resumption of rate-cut cycle should be accretive to markets

Key takeaways

- ◆ As expected, the FOMC voted at its September meeting to cut the federal funds target range by 0.25% to 4.00-4.25%, a first change after 9 months. Fed Chair Powell characterised it as a 'risk-management cut' as unemployment is still low and Fed forecasters may not have great confidence.
- ◆ We maintain our view of only two more 0.25% cuts (in December and next March) through end-2026 due to the resilient US economy and still low unemployment. However, the recent deterioration in labour market data is a dovish risk to our view as we may see little more easing than our forecast. This risk is reflected in the Fed's new projections, which now see two more cuts this year.
- ◆ With easing underway, resilient earnings in the face of tariffs, and upward earnings revisions, the prospects for S&P 500 corporate earnings suggest an acceleration over the next six quarters. Therefore, we maintain an overweight US equities stance. The tech revolution led by productivity-enhancing AI, nearshoring/onshoring and the reindustrialisation of the US continue to lift growth prospects and valuations. We also maintain an overweight on US IG credit and prefer medium-to-long duration Treasuries as growth moderates and the Fed eases gradually. We expect the USD to weaken further into year-end as Fed easing contrasts with G10 peers. Tariff/geopolitical risks remain a swing factor.



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What happened?

- The Federal Reserve cut the federal funds rate by 0.25% to 4.00–4.25%, ending a five-meeting hold. Governor Stephen Miran dissented, preferring a 0.5% cut. The Fed will continue reducing securities holdings (QT) despite the rate cut.
- The market reaction was mild, with quick but relatively small swings in both directions, as investors tried to reconcile with the constructive view on growth and small upward revisions in inflation with the fall in Fed's rate assessment.
- The median dot for end-2025 (showing Fed members' expectation of where rates will be at that time) was lowered to 3.625%, implying an additional 0.5% of easing this year. The median dot for 2026 was lowered to 3.375%, implying only a further 0.25% of easing next year.
- Revisions to the median economic projections were modest but mostly hawkish. Real GDP forecasts were revised higher. The median unemployment rate forecasts for 2026 and 2027 were actually nudged lower and the PCE core deflator projection was raised by 0.2% for 2026.

Median of the FOMC economic projections: September 2025

Variable %	Median				
	2025	2026	2027	2028	Longer run
Change in real GDP	1.6	1.8	1.9	1.8	1.8
June projection	1.4	1.6	1.8		1.8
Unemployment rate	4.5	4.4	4.3	4.2	4.2
June projection	4.5	4.5	4.4		4.2
PCE inflation	3.0	2.6	2.1	2.0	2.0
June projection	3.0	2.4	2.1		2.0
Core PCE inflation	3.1	2.6	2.1	2.0	
June projection	3.1	2.4	2.1		
Memo: Projected appropriate policy path					
Federal funds rate	3.6	3.4	3.1	3.1	3.0
June projection	3.9	3.6	3.4		3.0

Source: Federal Reserve, HSBC Private Bank and Premier Wealth as at 17 September 2025. Forecasts are subject to change.

- Since 1990, when the Fed resumes its monetary policy easing cycle, US financial markets tend to rally in the subsequent 12 months as US fixed income rises 7% and US markets rise 22%. US equity markets also outperform the rest of the world. Interest rate sensitive sectors, such as financials and technology, tend to lead during these periods.
- In the Q&A, Powell reinforced the Fed's commitment to independence, stressing that decisions are grounded in data, not politics.
- On tariffs, he said they're contributing about 0.3–0.4% to annual inflation, though pass-through to consumers has been smaller and slower than expected, with intermediaries absorbing costs. Possible labour-market effects can't be ruled out, but Powell emphasised that shrinking labour supply and weaker demand remain the dominant factors. Despite the tariff pass-through, corporate margins rose in Q2 (12.8% vs. 12.7% in Q1, above the five-year average of 11.7%).
- Powell described the cut as a “risk-management” step towards neutral, noting there was no appetite for a 0.5% move. He flagged rising unemployment among younger and more vulnerable groups, and suggested some participation declines are cyclical. AI may be affecting hiring of new graduates, though it isn't the main driver of labour softness.
- On housing, Powell said lower rates can provide some cyclical support, but structural shortages remain beyond the Fed's reach.
- On financial stability, Powell acknowledged rising delinquencies and weaker consumer credit scores but said households and banks remain in aggregate healthy, with no systemic risks. He stressed that short-term inflation expectations have moved higher alongside recent data, but long-term expectations remain firmly anchored near 2%.

Average performance 12 months after easing resumes: 6-prior easing cycles 1990 - Now

Index	Performance	Index	Performance
Bloomberg US Agg Bond Index	7.3%	S&P 500	21.8%
MSCI World Index	18.8%	Tech	30.0%
MSCI World Ex. US	18.1%	Financials	32.6%
Dow Jones	19.8%	Healthcare	13.8%
Nasdaq	33.8%	Consumer Discretionary	27.0%
Russell 2000	30.2%	Industrials	23.6%
Russell 3000	22.3%	Staples	14.4%
		Energy	19.6%
		Utilities	11.5%
		Materials	25.4%
		Communications	15.7%

Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 17 September 2025. Forecasts are subject to change.

Investment implications

- Beyond the Fed news, one additional consideration is the possibility of a government shutdown in October. If US congress cannot come to an agreement on funding, the government could shut down at 12:01am on 1 October. That remains a less likely outcome. House Republicans recently released a 91-page bill that would keep the government funded at current levels for seven weeks past the deadline. If a government shutdown were to happen, term premiums could rise, reflecting the increased risk. This could cause treasury yields to back up and create volatility for equity market investors.
- With easing underway, resilient earnings in the face of tariffs, and upward earnings revisions, the prospects for S&P 500 corporate earnings suggest an acceleration over the next six quarters. Therefore, we maintain an overweight US equities stance. The tech revolution led by productivity-enhancing AI, nearshoring/onshoring and the reindustrialisation of the US continue to lift growth prospects and valuations.
- Intraday market reaction had Treasury yields backing up as forecasts show higher potential inflation in 2026 and the dot plot shows a lot of dispersion in views. That said, we maintain an overweight US IG credit and prefer medium to long duration Treasuries as growth moderates and the Fed eases gradually. Locking in bond yields is important as cash rates fall. And while the curve is flat in the 2-5 year section of the curve, yields pick up after that, making it attractive to extend duration a bit.
- We expect the USD to weaken further into year-end as Fed easing contrasts with G10 peers. Tariff/geopolitical risks remain a swing factor.

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