The Interest Rate Pivot Begins

Key Takeaways

- The Fed reduced its policy rate by 25bp at the Sept. 17 FOMC Meeting.
- Q2 US GDP was revised higher to 3.3% q/q on strong private consumption and business spending. Still, the economy has cooled in 1H 25 versus 2024.
- GDI was boosted by tariff revenue, which did not appear to be offset by less income or profits elsewhere.
- We make modest revisions to the US outlook in favor of slightly stronger growth, a lower peak unemployment rate, and firmer inflation in 2026.
- Earlier Fed easing should reduce downside risk. Upside risks are driven by a greater fiscal push, animal spirits, and inflation tolerance.
- The FOMC is adopting a "Transitory Tariff" inflationary impact narrative in support of initiating the cutting cycle. We remain skeptical that the inflationary impacts will be one-time shocks.
- The Fed signaled a commitment to conventional monetary policy tools, including quantitative tightening, to exert downward pressure on longer-term rates.

Morgan Stanley expects rate cuts to continue for a terminal target range of 2.75-3.0% by end-2026.

Morgan Stanley

Target Fed Funds
(Midpoint, %)