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Fed cuts: How fast will M&A heat up as interest rates fall?
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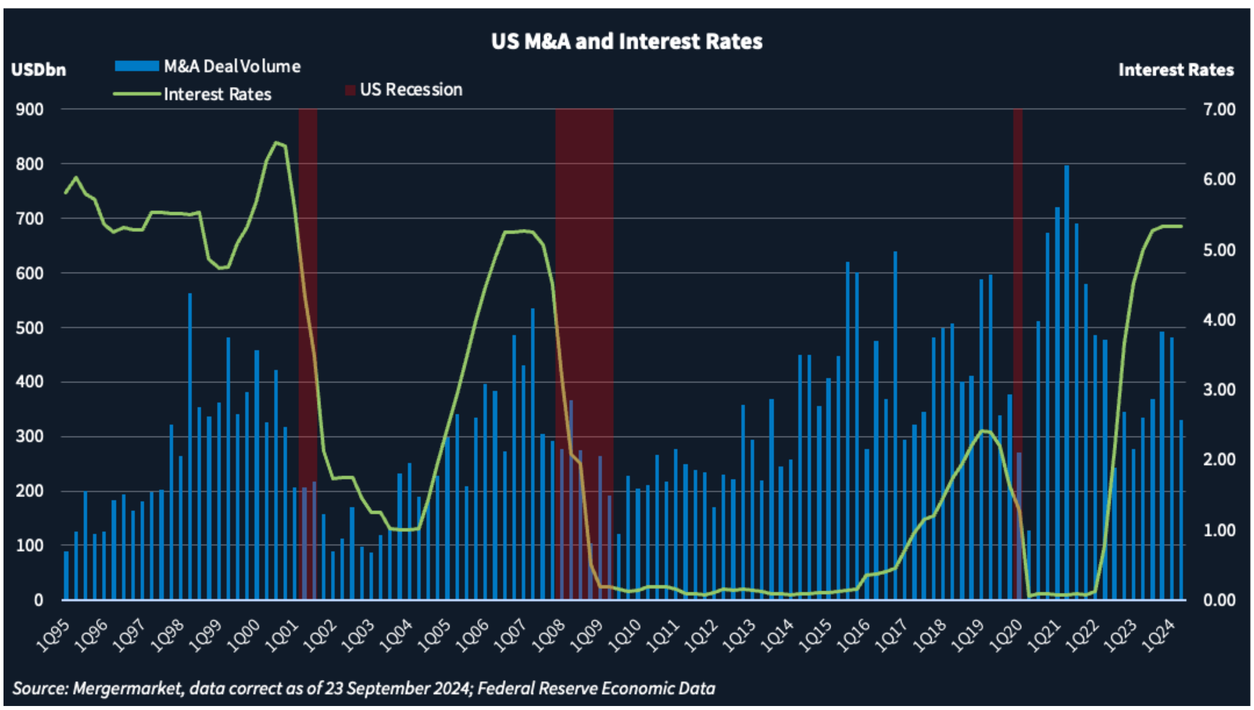
Think last week's drop in interest rates will lead to an immediate increase in M&A? Not so fast, say dealmakers.

Other factors – economic conditions, market sentiment, the presidential election, geopolitical conflict and a persistent valuation gap – will complicate the picture.

While dealmakers expect the 0.5% cut in rates to have a positive impact on M&A overall, any immediate impact is unlikely, with activity only expected to pick up in 2025.

The wide disconnect between what valuation sellers expect and buyers are willing to pay has hobbled M&A activity for more than two years.

Financial sponsors – who rely on debt to finance buyouts – will benefit from the lower cost of capital, bringing more bidders back to the dealmaking table. That in turn could help bridge some of the valuation gap, according to a tech banker and **Corpay**'s [NYSE:CPAY] Steve Greene, head of corporate development.



History lessons

The last three rate-cutting cycles in 2001-2002, 2007-2009, and 2020 were all in response to a weakening economy.

This time, the Federal Reserve is cutting rates when the economy is still robust, just as it was during the rate cuts of the mid-1990s. Between 1995 and late 1998, rates fell from 6% to 4.75%, precipitating an almost simultaneous increase in US M&A volume, according to *Mergermarket* data (see chart above).

The next rate-cutting cycle in 2001-2002 did not lead to an immediate recovery in M&A volume, however, as markets struggled to recover from the dotcom bust. M&A only began to recover in 2Q03 – when interest rates had been below 2% for more than a year. The rally in dealmaking continued even as rates began to climb again in 2005 and 2006.

The rate-cutting cycle in response to the unfolding Global Financial Crisis saw rates drop from 5.25% in September 2007 to near zero in December 2008. M&A volume did not begin to recover until after that rate-cutting cycle ended in 4Q09.

Measured optimism

Any uptick in activity during this cycle is expected to be slow and steady.

Bill Curtin, global head of **Hogan Lovells**' M&A practice, likens the trajectory of M&A over the next few quarters to the takeoff of a 747 jumbo jet. Weighed down by the baggage of presidential elections, the direction of the US economy, geopolitical risk, the regulatory environment and a persistent valuation gap, it will take longer to gain altitude.

"Transactions are occurring, but you don't feel like you're strapped onto the rocket of 2021 and 2022," Curtin says.

"A lot of people want to sell, and a lot of people want to buy, but the valuation gap remains wide enough where getting it over the finish line has been very difficult," says the tech banker. "We've seen a lot of processes that ultimately end up getting tabled." Clients are prepared to wait nine to 12 months for an improvement in the market, according to the banker.

Leaving the uncertainty around the presidential election behind will help. In a year like this, dealmakers still "feel more risk-off than risk-on," the banker adds.

The one wild card to a slow and steady improvement in M&A is whether the economy starts to contract, notes Corpay's Greene. The market has already seen a "recession in M&A" even without an economic recession alongside it, he says.

Weakening labor market data – non-farm payrolls for August were down year over year – are not worrying dealmakers yet, however. The half-point cut signals the Fed's confidence that the hoped-for soft landing of the economy is achievable, adds Curtin.

"We're not yet seeing anything that gives us reason to pause or reduce M&A activity," Greene says.

Provided the economy, the stock market and business performance all stay strong, M&A should accelerate slightly from the uptick seen in the last three quarters, says a second tech banker. Decisions made following last week's rate cut could lead to "a flurry of deals" being announced in 2Q25, especially as so much dry powder has been sitting on the sidelines, that banker adds.

More than anything, the 50-basis-point cut provides the psychological support for more dealmaking. "M&A is emotional, and it's driven by optimism about the future," the banker says.