Fed Watch

Fed pauses rate cuts to kick off 2025

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The implementation of policies that could spark an upward trend in inflation, even if temporary, could imply a more extended pause

- **The Fed kept the policy rate at 4.25-4.50%; the policy statement emphasized a stable labor market and sticky inflation as key factors influencing today's decision to pause rate cuts.** As we explained earlier this week (see), one of the reasons behind the recent Fed's cautious shift is the continued strength of the US economy, which in the Fed's view "has continued to expand at a solid pace." It is worth remembering that the initial 50bp rate cut in September of last year occurred amid increased concerns regarding labor market developments: the unemployment rate had risen to 4.2% in July of last year, after remaining within a range of 3.7% to 3.9% for the previous 12 months. Today's decision appears to be partly explained by the easing of those concerns and increased confidence in the labor market's strength, as subsequent data has shown that the unemployment rate "has stabilized at a low level" (the unemployment rate has been hovering around a 4.1-4.2% range for eight consecutive months). Besides, with core PCE inflation remaining at a "somewhat elevated" level in 2H24, the statement no longer acknowledges inflation "progress toward the Committee's 2 percent objective," even amid more encouraging recent readings. On the other hand, the December meeting minutes indicated that the Fed staff and some FOMC participants had already incorporated "placeholder assumptions"regarding the potential economic effects of the Trump administration's ambiguously-announced policy shifts into their economic projections. However, the forward guidance in today's statement remained unchanged[1]. This likely reflects the prevailing view among FOMC participants that it is still too early to formally acknowledge the implications for monetary policy of these potential policy changes within the statement.
- **All eyes were on any signals pointing to a more long-lasting pause amid the ongoing uncertainty around the potential effects of Trump's immigration and (upcoming) trade policies.** Powell continued to acknowledge that "in the current situation there is probably some elevated uncertainty because of significant policy shifts," but reiterated that it is too early to "know what will happen with tariffs, with immigration, with fiscal policy, and with regulatory policy." He concluded that they "will patiently watch [...] to get to a place of understanding what [their] policy response should be." By now, "the Committee is very much in the mode of waiting to see what policies are enacted." The minutes will likely shed more light on how the staff and FOMC participants have continued to incorporate these issues into their thinking. Powell reiterated that, given the continued economic strength, the Fed does not need to "be in a hurry to make further adjustments" and emphasized that their primary focus remains on "seeing real progress on inflation or alternatively some weakness in the labor market." Having cut 100 bps, he noted that the policy rate is "well positioned" to address any risks that may threaten the achievement of their goals. In his opinion, the policy stance is still restrictive, not "highly" restrictive, but "meaningfully" restrictive.
- **Neither the wording of the statement nor the Q&A gave a strong hint about the possible direction of the next policy decision scheduled for March.** Although the FOMC and Powell kept their options open, Powell

[1] In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks.

laid the groundwork for what could make the Fed cut rates in coming months (the labor market weakens unexpectedly or inflation falls more quickly than anticipated), while also paving the way for what could prompt the Fed to stay on the sidelines for an extended period (the economy remains strong and inflation does not continue to move sustainably toward 2%). Signs that core inflation is back on trend to 2% could open the door for another cut in the next meetings and up to 50bp worth of cuts in 2025, but the implementation of policies that could spark an upward trend in inflation, even if temporary, could imply a more extended pause. Although we continue to expect that the Fed will be able to cut rates in March, there is the risk that they have to keep rates on hold for an extended period. A cut at the next meeting is still possible if there are signs of less solid growth and the inflation readings in the intermeeting period point to more moderate inflation, but additional cuts (particularly our baseline assumption of an additional 25bp rate cut in June) could increasingly be at risk amid tariff-related price pressures later this year.

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