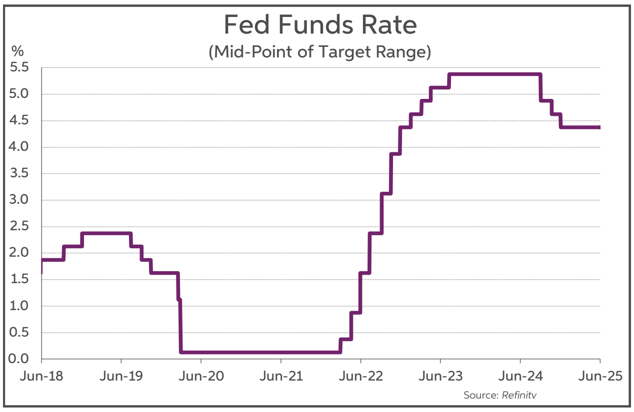
Fed Watch

AIB Treasury Economic Research Unit

19th June 2025

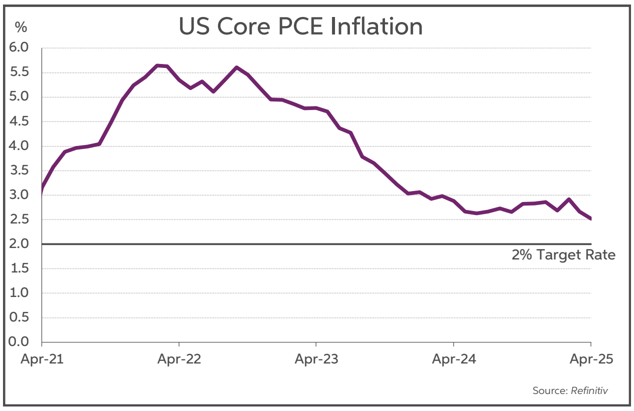
Fed remains in a holding pattern, with no rate cuts imminent

The June meeting of the US Federal Reserve Open Market Committee (FOMC) saw the central bank leave policy on hold. The target range for the Fed funds rate was maintained at 4.25-4.50%. This represented the fourth meeting in-a-row where the Fed left policy unaltered and was very much in line with market expectations. The FOMC was once again unanimous in its decision. The most recent interest rate changes from the Fed occurred over its final three meetings of 2024, when it reduced rates by a total of 100bps. **The meeting statement for June showed only minimal changes from May, and none of the amendments were significant from a policy guidance perspective.** The Fed maintains its assessment that "economic activity has continued to expand at a solid pace". Meanwhile, in terms of the economic outlook, it noted that uncertainty "has diminished but remains elevated".



Given there was no expectation of any rate changes from the Fed this month, a key focal point for markets was on the Fed's updated interest rate projections (i.e. dot plot). The June 'dots' continued to show that the median projection for 2025 was for 50bps in rate cuts, to a 3.75-4.00% range by year end. However, looking at the dispersion of dots indicates a hawkish shift among FOMC members for this year. Seven members now envisage no rate reductions this year (compared to 4 in March). Meanwhile, the median view for 2026 among the Committee is for just one 25bps of rate cut (was 50bps) to 3.6%. For 2027, rates are now seen as declining to 3.4% by year end. Further out, the "longer run" view is unchanged at 3%. In summary, the dots indicate an even more gradual pace of policy easing compared to March. **However, Fed Chair Powell noted in relation to the FOMC's dots that given the on-going elevated levels of uncertainty that "no one holds these rate paths with a great deal of conviction".**

Overall, the post-meeting press conference contained no surprises or new insights in terms of the outlook for official US interest rates. Chair Powell's remarks continued to indicate that the Fed is very much in a holding pattern, awaiting for clarity on tariffs and incoming data to see how the economy is performing over the coming months. He commented that "we feel like we're going to learn a great deal more over the summer on tariffs", its impact on inflation and that this is "going to inform our thinking". Chair Powell also stated that "in addition, we'll see how the labour market progresses". The wait-and-see stance against the backdrop of 'tariff related uncertainty' was further illustrated in his comment that "at some point, it will become clear". He once again emphasised that the view within the Fed is that "our policy stance is in a good place and we're well positioned to react to incoming developments".



Market expectations for official US interest rates are closely aligned to the Fed's projections for this year, with 50bps of easing being priced in. The market is currently attaching around a 70% probability to the first 25bps rate cut of 2025 happening in September. For 2026, the market is anticipating a slightly more dovish trajectory versus the Fed, with rates seen ending the year at 3.25-3.50%.

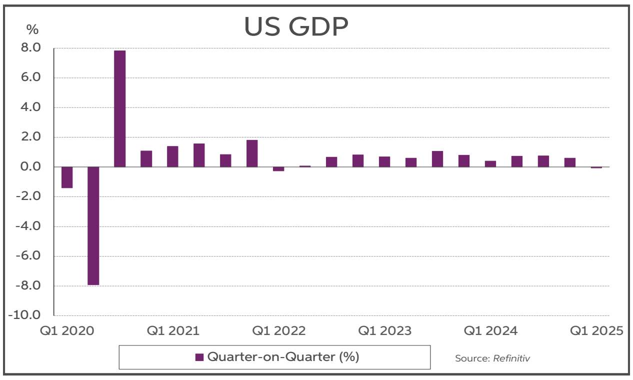
In conclusion, the latest communications from the Fed indicate that rate changes are not imminent, with the central bank in no hurry to cut rates, and any policy easing is unlikely to occur until after the summer at the earliest. In this context, Fed Chair Powell's scheduled speech at the Jackson Hole Economic Symposium on August 22nd would allow him the opportunity to tee markets up for any rate cuts before year end, as at this stage, the Fed itself is expecting the have greater clarity on tariffs and their economic impact.

David McNamara
Chief Economist
david.g.mcnamara@aib.ie

John Fahey
Senior Economist
john.j.fahey@aib.ie

Daniel Noonan
Economist
daniel.x.noonan@aib.ie

US economic growth projections scaled back

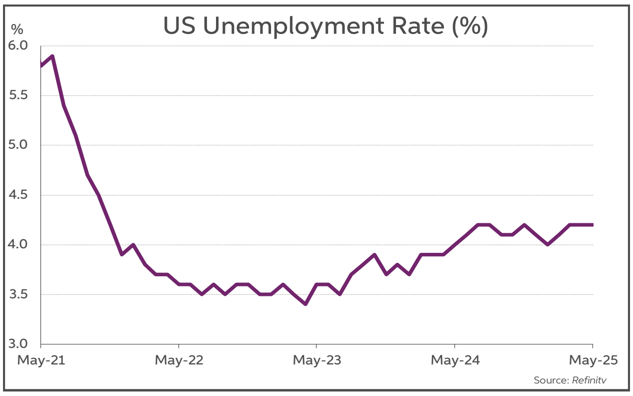


Having continued to perform very strongly last year, growing by 2.8% compared to 2.9% in 2023, US GDP contracted in Q1 2025. However, the 0.2% annualised retraction in growth was almost entirely driven by a surge in imports, as firms rushed to avoid tariffs. Goods imports jumped by 42.6% in Q1, far outpacing exports, meaning net trade knocked a whopping 4.9 percentage points (p.p.) from growth. The sharp rise in imports also meant that inventories contributed a hefty 2.6 p.p. to GDP. Meantime, government expenditure declined by 0.7%, clipping a meagre 0.1 p.p. from output. However, consumption and investment continued to perform well, suggesting that underlying economic conditions remain robust. Consumption added 0.8 p.p to the total, while fixed investment boosted activity by 1.3 p.p., led by an increase in business investment.

The available hard data in the second quarter have been soft. Retail sales registered consecutive monthly falls for the first time since Q4 2023, contracting by 0.1% in April and by 0.9% in May. It should be noted though that the control group measure (which excludes volatile components such as autos, fuel and food services) rebounded by 0.4% in May, after inching 0.1% lower in April. Elsewhere, industrial production declined by 0.2% in May, after a meagre 0.1% increase in April. However, in year-on-year terms, industrial output was up 0.6% in May.

Meanwhile, the recent survey data have been mixed, amid high levels of uncertainty regarding US trade policy. Having declined sharply in March/April, both the manufacturing and services PMIs improved in May, rising to 52.0 and 53.7, respectively. In contrast though, the manufacturing and non-manufacturing ISMs deteriorated in May, and printed in contraction mode. Meantime, having plunged to multi-year lows in April, both the University of Michigan and the Conference Board measures of consumer confidence have improved somewhat in May/June.

Regarding the labour market, conditions appear to have softened marginally this year, in-line with the overarching trend seen in 2024. The pace of payroll expansion has slowed slightly, averaging 155k per month so far in 2025, down from 209k in Q4 and 168k during the full year 2024. Meanwhile, the unemployment rate remained at 4.2% in May having oscillated between 4.0-4.3% over the past year. At the same time, labour demand remains relatively steady. The number of job openings stood at 7.4m in April, down from 7.5m in December, and from 8.5m at the start of 2024. Against this backdrop, average earnings growth has plateaued, printing at +3.9% y/y in each of the last five months.



Meanwhile, the disinflationary process has gathered momentum. Headline CPI stayed between 2.4-3.0% during September to March, before falling to 2.3% in April (its lowest level since February 2021) and edging back up to 2.4% in May. Core-CPI declined to 2.8% in March and has remained at that level so far in Q2, having been stuck in a narrow 3.1-3.3% range since last June. Similarly, core-PCE edged down to a low of 2.6% last June, but rose throughout the second half of 2024, to 2.9% in December. In April though, it declined to 2.5%, its lowest reading since March 2021. **Looking ahead, the Fed sees core–PCE rising to 3.1% in Q4, before falling to 2.4% in q4 2026 and to 2.1% in Q4 2027.**

In summary, the US economy entered 2025 on a firm footing. However, significant levels of uncertainty, especially regarding US trade policy, are weighing on consumer sentiment and clouding the outlook. Meanwhile, a downward trend in inflation has re-emerged recently (albeit higher tariffs pose upside risks to the inflation outlook), the job's market appears to be gradually slowing, and some activity measures have softened. Against this backdrop, markets are pricing in two rate cuts from the Fed in the second half of this year**. At the same time, the range of projections for the US economy has widened, but most forecasters have scaled back expectations for growth this year.** The IMF forecasts that US GDP will expand by 1.8% in 2025 and by 1.7% in 2026, compared to projections for growth of 2.7% and 2.1%, in January. Similarly, the Fed now sees US GDP rising by 1.4% y/y in Q4 (down from 1.7%) and by 1.6% y/y in Q4 2026 (down from 1.8%).

AIB, 10 Molesworth Street, Dublin 2 Tel: 353-1-6600311 https://aib.ie/investorrelations/economic-research-unit