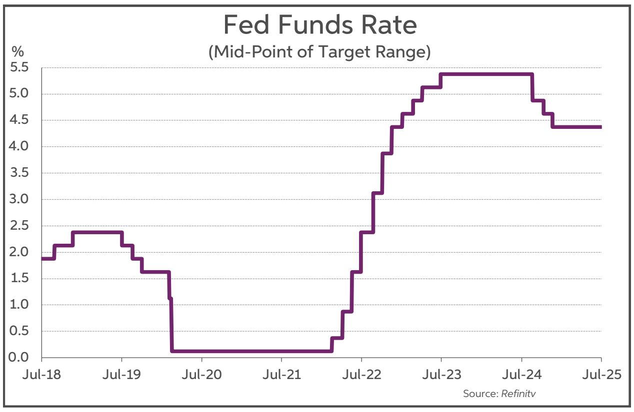
Fed Watch

AIB Treasury Economic Research Unit

31st July 2025

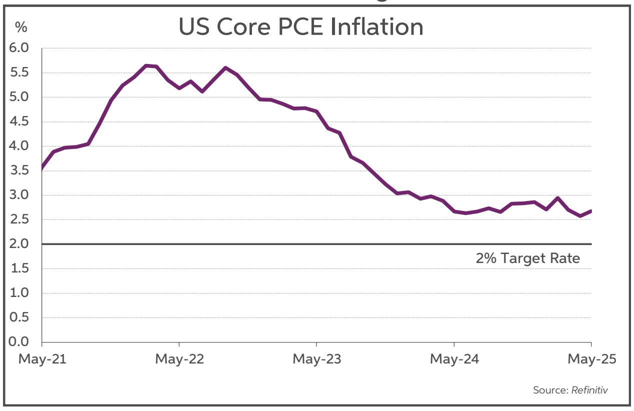
Fed still in wait-and-see mode

The US Federal Reserve Open Market Committee (FOMC) meeting for July saw the central bank, once again, leave policy on hold. The target range for the Fed funds rate was maintained at 4.25-4.50%. This represented the fifth consecutive meeting where the Fed left policy unaltered. 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 July FOMC outcome was very much in line with market expectations. **However, unlike at the June meeting, the FOMC was not unanimous in its decision**. Two FOMC members (Bowman and Waller) voted in favour of an immediate rate cut of 25bps. Both of these Board members had alluded to this possibility in comments in the lead up to the meeting.



The meeting statement for July showed only minimal changes. The Fed acknowledged the easing in the pace of expansion, stating that "growth had moderated in the first half of the year". This compares to its previous assessment in June that "economic activity has continued to expand at a solid pace". The Fed maintained its view that labour market conditions remain "solid" and inflation continues to be "somewhat elevated".

The most recent update the Fed provided on its interest rate projections (i.e. dot plot) was at the June FOMC. 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, the dispersion of dots indicated a hawkish shift among FOMC members for this year. Seven members in June envisaged no rate reductions in 2025 (compared to 4 in March). Meanwhile, the median view for 2026 among the Committee was for just one 25bp rate cut (was 50bps) to 3.50-3.75%. For 2027, rates were seen declining to 3.25-3.50% by year end. Further out, the "longer run" view was unchanged at 3%. Overall, the June 'dots' indicated an even more gradual pace of policy easing compared to March".



With no rate changes envisaged and no updated forecasts scheduled for release, the main focus for markets for the July FOMC was on the post-meeting press conference to see, if any guidance was forthcoming from Chair Powell on the potential timing of future rate cuts. His general remarks continued to indicate that the Fed is very much in a holding pattern, awaiting data to see how the economy is performing amid the significant changes in US tariff policy. Chair Powell kept his options open regarding a rate cut in September. He noted that by then, the FOMC will have "two full rounds of employment and inflation data", while also stating the FOMC has made "no decision about September" but will take the data "into consideration".

Market expectations firmed in the aftermath of the press conference, reflecting the lack of any clear signal from Chair Powell about a September cut and some better than expected US macro data. Futures contracts are now attaching around a 45% probability to a rate cut in September (66% prior to the meeting). In total, there is around 35bps of easing priced-in by year end (vs. pre-meeting 45bps).

In conclusion, the July FOMC indicated that data will determine any policy changes, from the Fed. Markets will be paying close attention, just like the Fed, to incoming macro data, including this Friday's July payroll numbers as well as inflation metrics to see if these indicators are consistent with the Fed resuming its rate cutting cycle. Aside from the data, Fed Chair Powell's scheduled speech at the Jackson Hole Economic Symposium on August 22nd will also warrant attention. This would be an opportune occasion for the Fed Chair to tee markets up for a rate cut, at its next meeting on September 16th/17th.

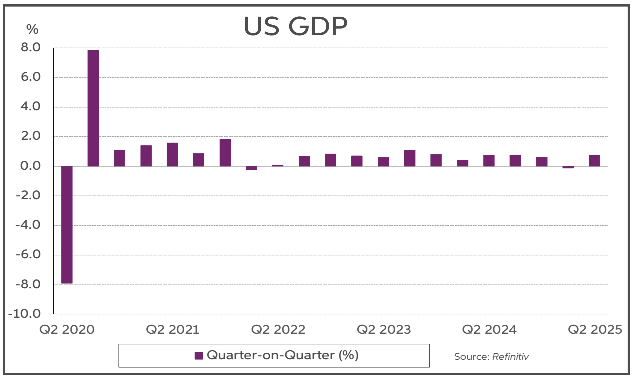
David McNamara
Chief Economist
david.g.mcnamara@aib.ie

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

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

AIB

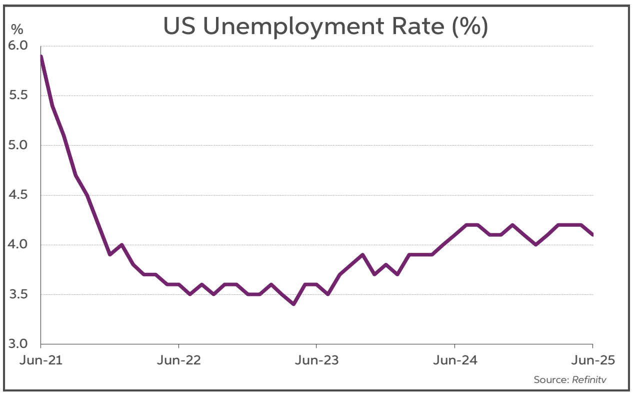
US economic growth slows markedly in H1



Having performed very strongly over the past two years, expanding by 2.9% in 2023 and by 2.8% in 2024, US economic growth has slowed in the first half of 2025. GDP contracted by 0.2% annualised in Q1 before rebounding by 3.0% in Q2. This translates to a quarterly contraction of 0.1% in the first quarter and a 0.7% q/q expansion in the second. However, very sharp swings in imports, amid tariff front-running, has created significant volatility in the data. Indeed, goods imports surged by 8.4% q/q in Q1 before falling by 6.8% in Q2. Meantime, a closer examination of the details indicates that the US economy has lost momentum. Personal consumption has risen more slowly, up by 0.1% in Q1 and 0.4% in Q2, compared to an average growth rate of 0.9% per quarter in 2024. Fixed investment has increased at a slightly faster pace in the first half of 2025, rising by 2.8% compared to 2.2% last year, but the Q2 outturn was weak, at +0.1% q/q. Meanwhile, government spending essentially flat-lined in the first six months of 2025. It is no surprise then, that real domestic final sales expanded by just 0.6% in H1 2025, less than half of the 1.3% and 1.9% rates of expansion seen in 2023 and 2024.

Furthermore, the very limited survey data available at the beginning of Q3 have been mixed. The flash reading of the services PMI jumped to 55.2 in July, its highest level since December, consistent with an increase in activity levels in the sector. In contrast though, the manufacturing PMI moved back into contraction mode, falling to 49.5 in the month. Meantime, consumer confidence has improved but it remains muted overall. Both the Conference Board and the Michigan measures increased slightly in July, but they were coming off low bases and they remain well below their levels at the start of the year. Similarly, homebuilder sentiment rose for the first time since January in July, although it remains quite subdued overall.

Regarding the labour market, conditions appear to have softened further this year, in-line with the overarching trend seen in 2024. The pace of payroll expansion has slowed, averaging 130k in the first six months of 2025, down from 209k in Q4 and 168k during the full year 2024. Meanwhile, the unemployment rate stood at 4.1% in June having oscillated between 4.0-4.3% over the past year. At the same time, labour demand remains relatively steady. JOLTs job openings were just over 7.4m in June, which is broadly in the middle of the 7.2-7.7m range throughout 2025. Against this backdrop, average earnings growth has eased this year, falling to +3.7% y/y in June, its lowest level since July 2024.



Meanwhile, after some disinflation at the start of the year, there are now tentative signs of tariff-related inflationary pressures emerging. For example, headline CPI fell to 2.3% in April, its lowest level since February 2021, before edging up to 2.4% in May and rising to 2.7% in June. Elsewhere, core-CPI declined to 2.8% in March and remained at that level in the first two months of Q2 but it increased to 2.95 in June. Similarly, core-PCE edged down to a low of 2.6% last April, only to re-accelerate to 2.7% in May. Looking ahead, the Fed sees core-PCE rising to 3.1% in Q4.

In summary, the US economy entered 2025 on a firm footing. However, significant levels of uncertainty, especially regarding US trade policy, have weighed on consumer sentiment and are still clouding the outlook. At the same time, conditions in the labour market have continued to soften. Against this backdrop, economic growth has slowed throughout the first half of 2025. Furthermore, signs are starting to emerge that higher tariff rates are exerting some inflationary pressures on consumer prices, which threatens to un-do the disinflationary trend that regained momentum earlier this year. In recent weeks though, the US has agreed several trade deal frameworks with some of its key trading partners, which should remove some of the uncertainty that has been weighing on the economy. Nevertheless, slower growth is now expected for the US this year. The IMF forecasts that US GDP will expand by 1.9% in 2025 compared to projections for growth of 2.7% in January. Nex year US GDP is expected to rise by 2.0%.

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