

Fed gives no signs that rate cuts are imminent

As expected, the May meeting of the US Federal Reserve Open Market Committee (FOMC) 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% for a third consecutive meeting. The decision by the FOMC to leave rates unchanged was unanimous. 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.

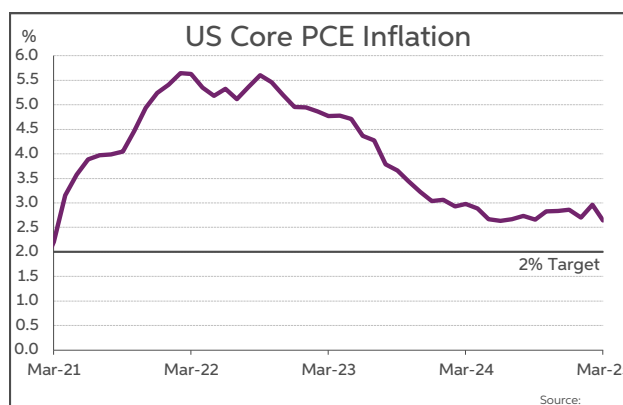
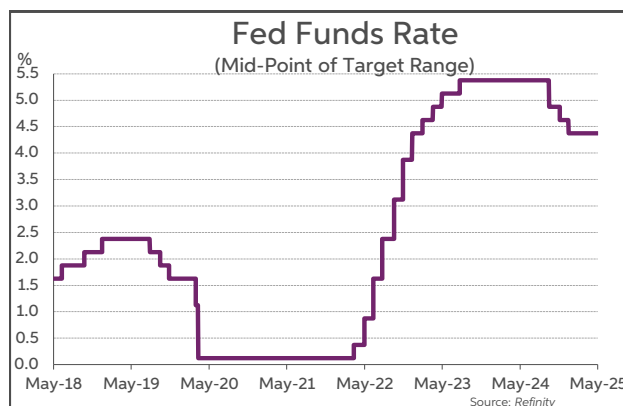
The meeting statement for May was broadly similar to its previous version from March. The Fed stated that volatility in net exports impacted GDP in the first quarter and remained of the view that “economic activity has continued to expand at a solid pace”. It also continued to say that “labour market conditions remained solid” and “inflation remains somewhat elevated”. However, the Fed did acknowledge the more uncertain economic outlook, noting that “the risks of higher unemployment and higher inflation have risen”.

In the press conference, Fed Chair Powell's comments provided further explanation as to why the Fed held steady on rates in May. He stated that the FOMC believes its current interest rate setting leaves the central bank “well positioned to respond in a timely way to potential economic developments”. The last detailed set of interest rate projections were released by the Fed at its March meeting. These ‘dots’ were unaltered from their December edition, continuing to indicate a very gradual pace of rate cuts. The median projection is that rates will decline to a 3.75-4.00% range by end-2025, which implies 50bps of rate cuts this year. Rates are envisaged to be cut by a further 50bps in 2026 and by 25bps in 2027, falling to a 3.00-3.25% range.

In terms of any policy guidance at this month's meeting, it was clear from Fed Chair Powell's comments during the press conference that the central bank is very content with the current level of its key interest rate and he gave no indication that any rate cuts from the Fed are imminent. His remarks indicated that the FOMC is very much in ‘wait-and-see’ mode, to ascertain what impact the new US tariff policy will have on the US economy. Chair Powell commented that because the Fed believes its interest rate policy is “well positioned” the Fed does not “have to be in a hurry” to alter policy. He elaborated by saying that there would be cases where it would be “appropriate to cut interest rates this year” but also “cases in which it wouldn't”.

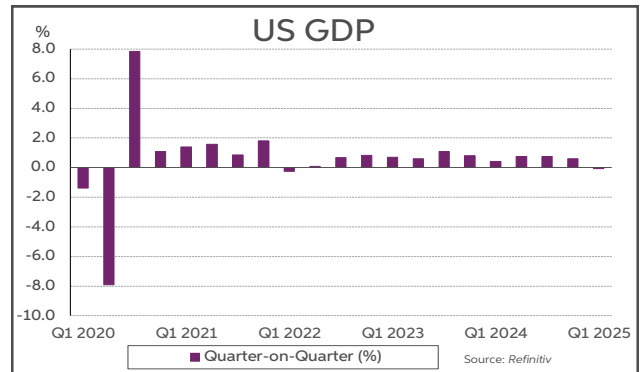
Market expectations for official US interest rates have softened since early April when President Trump announced the significant shift in trade policy. Futures contracts are consistent with around 75bps of rate cuts in 2025. This would see official rates end the year in a 3.50-3.75% range. The first rate cut is expected at its July 30th meeting.

Of course the extent and timing of rate cuts this year will to a large extent depend on the impact that the new trade policy will have on the US economy. The Fed has noted previously that it could cause some tension in its dual mandate of stable prices and maximum employment. Indeed, this month's statement called out the risks of “higher unemployment” and “higher inflation”. The Fed though, through Chair Powell's comments has been quite clear in stating that it is in no hurry to cut rates and will wait for clarity to see how the economy evolves before deciding to lower rates this year. If the hard data start to deteriorate, especially in relation to the jobs market, then the Fed will likely cut rates. However, if the data holds up, suggesting resilience in the economy, then the Fed may remain on hold and disappoint market expectations for 75bps of easing over the remainder of the year.



US economic outlook clouded by trade policy uncertainty

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 0.3% annualised retraction in growth at the start of the year was entirely driven by a surge in imports, as firms rushed to avoid tariffs. Goods imports jumped by 50.9% in Q1, far outpacing exports, meaning net trade knocked a whopping 4.8 percentage points (p.p.) from growth. The sharp rise in imports also meant that inventories contributed a hefty 2.3 p.p. to GDP. Meantime, government expenditure declined by 1.4%, clipping a modest 0.3 p.p. from output. However, it should be noted that consumption and investment continued to perform well, suggesting that underlying economic conditions remain robust. Consumption added 1.2 p.p. to the total, while fixed investment boosted activity by 1.4 p.p., led by an increase in business investment.

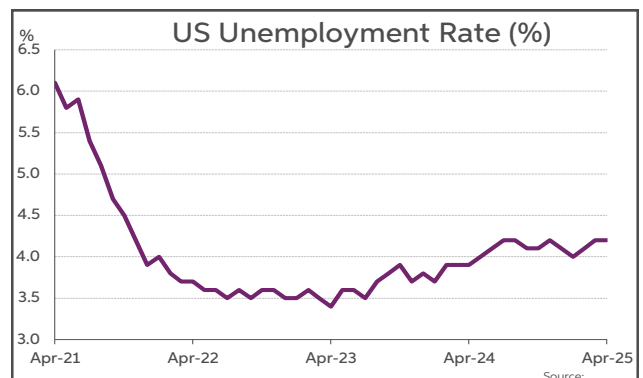


Regarding the labour market, conditions appear to have continued to soften so far this year, in-line with the overarching trend seen in 2024. The pace of payroll expansion has slowed slightly, averaging 144k per month in the first four months of 2025, down from 209k in Q4 and 168k during the full year 2024. Meanwhile, the unemployment rate remained at 4.2% in April, having oscillated between 4.0-4.3% since last May. At the same time, there are signs that labour demand has cooled. The number of job openings stood at 7.2m in March, down from 7.5m in December, and from 8.5m at the start of 2024. Amid the softening in labour demand, average earnings growth has eased marginally, to +3.8% y/y in March/April, compared to +4.2% y/y a year ago.

Meanwhile, the disinflationary process has gathered steam in Q1. Headline CPI printed between 2.6-3.0% during October to February, before falling to 2.4% in March, matching its September 2024 low. Meantime, core-CPI declined to 3.1% in February and to 2.8% in March, having been stuck in a narrow 3.2-3.3% range since last June. Similarly, core-PCE edged down to a low of 2.6% in June, but rose throughout the second half of 2024, to 2.9% in December. In March though, it declined to 2.6%, matching the aforementioned low in 2024.

The limited amount of survey data available for Q2 have been mixed, amid high levels of uncertainty regarding US trade policy. The manufacturing PMI remained at 50.2 in April, having declined markedly in March. Meantime, the services PMI fell sharply to 50.8 in April, its weakest reading since November 2023. In contrast, both the manufacturing and non-manufacturing ISM improved in April, albeit the former remained in contraction territory, at 48.7. However, consumer confidence has been dire, with both the University of Michigan and the Conference Board measures plunging to their lowest levels since June 2022 and May 2020, respectively.

To summarise, the US economy entered 2025 on a firm footing. Furthermore, tariffs appear to have impacted sentiment more than underlying activity to date. At the same time, a resumption of the downward trend in inflation, and an additional slowdown in the job's market at the start of the year should allow the Fed to lower rates further in 2025, if needed.



However, significant levels of uncertainty at present, especially in relation to US trade policy, is clouding the outlook. Against this backdrop, the range of forecasts for the US economy has widened markedly, but most institutional forecasters have scaled back expectations for growth this year. The IMF now sees US GDP expanding by 1.8% in 2025 and by 1.7% in 2026, compared to projections for growth of 2.7% and 2.1%, in January. Substantial increases in tariffs also threatens to weigh on the labour market and push-up inflation, placing both elements of the Fed's dual mandate in tension and complicating it's task to set monetary policy. It should also be noted that firms and consumers may not feel the full impact of the changes in US tariffs until the second half of the year. At which point though, the US may have agreed a number of trade deals and sentiment may have improved, boosted also by an extension of tax cuts passed during Trump's first term. However, even if a number of trade deals are signed, it seems unlikely that the effective average tariff rate on US imports will return to the 2.4% rate seen in 2024. Recent estimates put it at roughly 18%. Thus, it is clear that the US economic outlook is likely to remain highly uncertain for some time still.

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