

A Skip, Not a Pause



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INTEREST RATES & FED POLICY

Our outlook will have annual inflation decelerating through the winter, likely permitting another rate cut at the March FOMC meeting.



The Federal Reserve Open Market Committee (FOMC) held its target for interest rates unchanged at a range of 4.25% – 4.50%, a “skip” after three meetings in which the Fed cut a total of 1% from the fed funds rate. We use the word “skip” rather than “pause,” since the direction of travel for overnight rates remains lower, albeit at a slower pace. If inflation readings play ball over the next two data points, Powell & colleagues will be in a position to cut rates once again by the March FOMC meeting. That’s a pretty big “if,” but there are both fundamental and extra-seasonal factors that could drive the core PCE slightly lower in the coming months.

Data since the FOMC met in mid-December has been generally strong. While the official read on 4Q GDP growth is not out until tomorrow, it appears that overall economic activity will have expanded in the 2.6% – 2.8% range—a bit slower than the prior quarter, but healthily above the long-run trend. Underneath the hood, job gains continue apace, consumer spending held in strong through the critical holiday period, and measures of corporate spending were decent. On that last point, we are probably seeing some “pull-forward” orders ahead of possible tariffs and higher costs in 2025. When it comes to prices, there has really only been a single data point since the last meeting, namely December CPI. Despite the thin inflation calendar, it looks like the Fed’s preferred core PCE inflation measure will hit on the low side of +0.2% for Dec, returning the 3-month annual rate of core PCE inflation to +2.2%. That’s where our thesis for a March cut lies: the 6-month run rate of PCE inflation will likely be lower in March 2025 than it was when the Fed started cutting in September 2024. The growth story does not demand further rate cuts, but the inflation story should gently nudge the central bank in that direction.

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