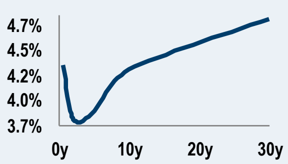
INVESTMENT STRATEGY GROUP
FOMC COMMENTARY

May 7, 2025

CAUGHT IN THE EDDIES

- Federal Reserve policymakers left unchanged its target for overnight rates at a range of 4.25% – 4.50%, the third consecutive hold
- Economic cross-currents are unusually messy, though we anticipate they will resolve with labor market downside, spurring mid-2025 cuts
- The FOMC statement seemed more concerned about both inflation and growth risks, which is development without recent precedent
- Initial market response was moderately negative for risk assets and moderately positive for the yield curve

Treas.	2.15PM	1.45PM	Chg.
3mo	4.31	4.31	-(0.00)
2yr	3.76	3.79	-(0.02)
5yr	3.86	3.88	-(0.02)
10yr	4.26	4.28	-(0.01)
30yr	4.76	4.77	-(0.01)
3m/2s	(55)	(53)	-(2)
2s/10s	50	49	+1
2s/30s	100	98	+1



Source: Bloomberg

The Federal Reserve Open Market Committee (FOMC) held its target for interest rates unchanged at a range of 4.25% – 4.50%, its third consecutive meeting of no action. On the margin, however, monetary policy officials seem to see increased risks to economic growth that could affect the labor market in the coming months. In contrast to most overseas institutions, the Fed has always been a "growth first" central bank, but Gov. Chris Waller's recent interview in which he hinted at aggressive cuts if the labor market weakens truly highlighted this view. For the moment, however, policymakers remain stuck in the eddies, unable to paddle upstream against inflation or downstream in support of growth risks.

Data since the FOMC met in mid-March has been, for lack of better word, confusing. The first read on 1Q GDP growth indicated overall economic contraction of -0.3%, but "core" economic strength of +3.0%, in line with that of 2023 – 2024 (real final sales to private domestic purchasers). Core PCE inflation has been volatile month-to-month, but as of the most recent report, it ran at a toasty +3.5% annualized rate during the first quarter. Jobs data have been decent on the surface, with monthly gains through April, but weaker underneath, with extended durations of unemployment and faster growth in lower-income categories. The trade deficit ramped up massively, corporate inventories have been all over the map, and residential investment looks to be doing loop-de-loops. Economist colleagues have labeled this period "Schrodinger's economy," or called it a "Wile E Coyote moment." The problem today is that the April 2 tariff announcements have completely altered economic incentives, creating a hard break between a pre-April economy (for which we have data!) and a post-April economy (for which we do not!). Firms facing higher tariffs are probably just now putting business and hiring/firing plans into motion four weeks after the initial announcements. Against that backdrop, it is almost impossible for the Federal Reserve to act. Central banks are not quick response institutions, full stop. At best guess, it will take until the July meeting until the Fed can even tell which direction post-April economic variables are trending. No matter what markets want, the real economy simply does respond fast enough to policy developments for us to have a confident outlook.

There were a few changes to the FOMC statement, starting with a dismissal of the validity of recent economic data. The FOMC acknowledged that "Although swings in net exports have affected the data…economic activity has continued to expand. That is a clear reference to artifacts in the aforementioned 1Q GDP release. Much more significantly, the statement included the warning that "risks of higher unemployment and higher inflation have risen." Offhand, we cannot recall a precedent for the FOMC formally increasing its risk assessment on both sides of its mandate, certainly not so starkly.

Immediate market reaction to today's FOMC announcement had risk assets selling off, though it is worth noting that these declines come against a backdrop of volatile intraday equity markets. Interest rates were somewhat lower across the curve, though not convincingly so. Finally, the dollar was somewhat weaker post-release, though within the day's range. One should take these market moves with a sizable grain of salt, as the White House issued some trade comments concurrent to the FOMC announcement.

FEDERAL RESERVE press release

•Trade has masked what are otherwise okay economic numbers

Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook has increased further. The Committee is attentive to the risks to both sides of its dual mandate and judges that the risks of higher unemployment and higher inflation have risen.

•Risks to both growth and inflation upgraded materially

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. 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. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

• Voting unanimous; Kashkari filling in for Schmidt

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; Neel Kashkari; Adriana D. Kugler; Alberto G. Musalem; and Christopher J. Waller. Neel Kashkari voted as an alternate member at this meeting.

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