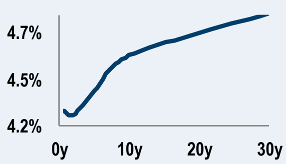
Jan 29, 2025

A SKIP, NOT A PAUSE

- Federal Reserve policymakers left unchanged its target for overnight rates at a range of 4.25% – 4.50%, a hold after 100 bps of cuts
- Today's action is a "skip," not a "pause," as the direction of travel remains towards further cuts, albeit with uncertain timing
- Our outlook will have annual inflation decelerating through the winter, likely permitting another rate cut at the March FOMC meeting
- The Fed has no clarity on tariff or immigration policy nor on the economic effects thereof; for the moment, they will continue to ignore

Treas.	2.15PM	1.45PM	Chg.
3mo	4.28	4.28	+0.00
2yr	4.26	4.22	+0.04
5yr	4.39	4.35	+0.04
10yr	4.58	4.55	+0.03
30yr	4.81	4.79	+0.02
3m/2s	(3)	(7)	+4
2s/10s	33	34	-(1)
2s/30s	55	57	-(2)



Source: Bloomberg

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.

There were a handful of changes in the FOMC statement accompanying today's meeting, all referencing the Fed's economic assessment. The labor market "has stabilized" with unemployment "at a low level," an implicit reference of full employment. Importantly, that is an upgrade from the concerns expressed in late-summer 2024. Inflation has no longer "made progress" but rather "remains somewhat elevated." That seems a bit like a mark-to-market comment, as it is simply hard to imagine inflation decelerating as suddenly as it did last year. On the margin, the shifts to the economic assessment might be marked hawkish, but the change is incremental, not significant.

Immediate market reaction to today's FOMC announcement was somewhat negative but well within the range of noise—not surprising as the Fed delivered the "nothing" that the markets expected. The marginal hawkishness came forward in a small increase in yields across the curve. Equity markets were slightly weaker in the moments after the release, but not significantly so. The dollar, through which monetary policy has hit the broader markets in recent months, was somewhat higher against major trading counterparties, but once again, within the range of normal daily trading noise. It has been more than six months since the Fed "didn't matter" to markets, but it seems like we're back in one of those periods again today.

FEDERAL RESERVE press release

• U-rate has stabilized, hinting at full employment; inflation still a bit high

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. The Committee judges that the risks to achieving its employment and inflation goals are roughly in balance. The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate.

• No other changes to the FOMC statement

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 is back to unanimous

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; Adriana D. Kugler; Alberto G. Musalem; Jeffrey R. Schmid; and Christopher J. Waller.

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