MONETARY AFFAIRS:

Review: Fed Leaves Rates Unchanged,

And Signals A More Cautious Approach to Easing

by

Brunello Rosa and Nato Balavadze

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Executive Summary

- **Decision Made**: *The Fed hold US interest rates steady.* The FOMC kept the Fed funds rate steady at 4.25%–4.50%. The Fed maintained its data-dependent approach, signalling that rate decisions will continue to be made on a meeting-by-meeting basis. The FOMC statement was little changed from May, noting "solid" economic growth, "low" unemployment, and "somewhat elevated" inflation. While only four officials expected no rate cuts in March, that number has now doubled. Meanwhile, eight still anticipate two quarter-point cuts this year, down slightly from nine.
- **Policy Discussion**: *Fed Chair Powell stated the central bank can afford to wait on rate changes, citing early signs that tariffs are pushing inflation higher.* The Fed paused its rate-cutting cycle in January after lowering borrowing costs by a full percentage point in late 2024. Since then, policymakers have adopted a "wait-and-see" stance, holding off on major moves until there is more clarity on the economic impact of President Trump's policies.

  Market expectations for a rate cut have grown. Futures now imply a 64% chance of a cut in September, up from 58% before Wednesday's decision to hold rates steady at 4.25%–4.50%. Traders have also raised the likelihood of another cut in October. While the Fed still anticipates some easing this year, it signaled a slower pace, citing the inflationary risks tied to Trump's tariff hikes. Futures now price in 50 basis points of cuts in 2025—up slightly from 46 bps—matching the Fed's projections. However, forecasts for 2026 and 2027 have been pared back to just one 25 bp cut each.

  At his press conference, Powell described current monetary policy as "modestly restrictive," meaning interest rates remain high enough to curb economic activity. He noted that recent inflation forecast revisions were largely due to sharply increased tariffs in April. Powell warned that tariffs ultimately raise costs throughout the supply chain, with much of the burden falling on consumers. Powell stated that "without tariffs" confidence that inflation is coming down would be building.

  Labor market cooling has been gradual, with unemployment edging up slightly as immigration slows and job growth weakens. While inflation remains contained for now, delayed effects, weaker demand, and global tensions—especially between Israel and Iran—add pressure. Meanwhile, Trump has lashed out at the Fed for not cutting faster, pushing for rates two points lower to ease mounting interest costs on the $36 trillion national debt, which is set to hit $1.2 trillion this year and push the deficit near $2 trillion.

- **Changes to Economic Outlook:** *The Fed expects higher inflation and slower growth.* GDP slipped slightly in Q1 after 2.5% growth last year, partly due to businesses front-loading imports ahead of potential tariffs. Still, private domestic final purchases rose by 2.5%, supported by recovering business investment, though consumer spending slowed.

  The Fed's latest projections reflect a weaker outlook than in March, with GDP growth expected at 1.4% in 2025 (down 0.3 pp), unemployment rising to 4.5%, and inflation reaching 3% (from the 2.7% expected in March). Core PCE inflation was also revised up to 3.1% (from 2.8%). While labor market conditions remain solid—with steady job gains and low unemployment—sentiment has softened, and wage growth is moderating. Despite tariffs lifting short-term inflation expectations, long-term expectations remain anchored. The Fed's updated dot plot still shows two cuts in 2025, but projections for 2026 and 2027 were trimmed, signaling lingering uncertainty. The median rate is now seen at 3.4% in 2027, with more officials expecting no cuts this year than in March.

Key Picture: US Federal Reserve Forecasts – 2025-2027

	2025f			2026f		2027f		Longer Run	
	Latest Reading	June Report	March Report	June Report	March Report	June Report	March Report	June Report	March Report
GDP *(real growth, y-o-y)*	2.1	1.4	1.7	1.6	1.8	1.8	1.8	1.8	1.8
Unemployment rate *(%, y-o-y)*	4.2	4.5	4.4	4.5	4.3	4.4	4.3	4.2	4.2
PCE Inflation *(%, y-o-y)*	2.1	3.0	2.7	2.4	2.2	2.1	2.0	2.0	2.0
Core PCE Inflat. *(%, y-o-y)*	2.5	3.1	2.8	2.4	2.2	2.1	2.0	-	-
Federal Funds Rate *(%)*	4.327	3.9	3.9	3.6	3.4	3.4	3.1	3.0	3.0

Source: Federal Reserve '*Summary of Economic Projections'* June and March 2025. *Note:* 1. GDP reading for Q1-2025; 2. Unemployment rate as of May 2025; 3. PCE and core PCE inflation as of May 2025; 4. Projections reflect the median of FOMC projections

Analysis

- **DECISION MADE**: *On June 18, the US Federal Reserve's FOMC held its Fed funds range unchanged at 4.25% - 4.50%.* The Statement expressed reduced concern about economic volatility and trade policy uncertainty from the White House. FOMC expects to make two reductions later this year.

  Regarding *forward guidance*, the Fed continues to be data-dependent with decisions being made meeting by meeting. The FOMC's statement remained largely unchanged from May. The committee noted that the economy continued to expand at a "solid pace," with unemployment staying "low" and inflation still "somewhat elevated." The Fed stated: "*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 FOMC statement also said that: "*The Committee is attentive to the risks to both sides of its dual mandate"* but removed *"judges that the risks of higher unemployment and higher inflation have risen*."

  Back in March, only four officials anticipated no rate cuts in 2025. Now, eight officials still expect to lower rates twice by a quarter point this year, slightly down from nine in March.

  Regarding *balance sheet policies*, the Fed in May last year decided to slow down the pace of QT from June. The Committee plans to further decrease its Treasury securities, agency debt, and agency mortgage-backed securities holdings. Starting in April, the Committee will slow the reduction of its securities holdings by lowering the monthly Treasury redemption cap from $25 billion to $5 billion, while keeping the agency debt and mortgage-backed securities cap at $35 billion.

- **POLICY DISCUSSION:** *Fed Chair Jerome Powell said the Fed can afford to wait on rate changes, noting early signs that tariffs are starting to impact inflation.* The Fed halted rate cuts in January after lowering borrowing costs by 1% in late 2024. Since then, officials have adopted a "wait-and-see" approach, holding off on major decisions until there's more clarity on the economic impact of President Trump's policies. Federal funds futures now imply a 64% chance of a rate cut in September, up from 58% before the Fed held rates steady at 4.25%–4.50% on Wednesday. Traders also raised odds of another cut in October. While the Fed still expects rate cuts this year, it signaled a slower pace of easing amid Trump's tariff plans. Futures now price in 50 bps of cuts in 2025—up slightly from 46 bps—aligning with the Fed's unchanged forecast. Projections for 2026 and 2027 were trimmed to just one 25 bp cut each.

Fed officials remain cautious, worried Trump's tariffs could trigger inflation, though price data so far show minimal impact. Delayed tariff effects, weaker demand, and inventory build-ups have helped cushion any price increases. The Israel-Iran conflict adds uncertainty, with potential energy price spikes discouraging cuts. Still, signs of economic cooling—rising layoffs, declining consumer spending, and slumping retail and housing data—may push the Fed to ease later this year.

During the press conference, Fed Chair Powell described current monetary policy as "modestly restrictive," meaning interest rates are high enough to slow economic activity. He attributed the recent upward revisions in inflation forecasts to the impact of US tariffs, which were sharply increased in April. Powell stated that "without tariffs" confidence that inflation is coming down would be building. Tariffs inevitably raise costs for businesses and consumers. While each link in the supply chain—from manufacturers to retailers—will try to avoid absorbing the added expense, Powell said, "ultimately, someone has to pay," and that burden often ends up with the consumer.

While Powell declined to comment directly on immigration policy, he acknowledged that a slowdown in immigration is likely contributing to weaker growth in the labor supply. At the same time, a cooling economy is reducing demand for workers. This combination, he explained, helps explain why the unemployment rate has inched up only gradually, even as job growth has slowed.

Trump continues to attack the Fed, criticizing Chair Jerome Powell for not cutting rates and calling him "stupid." He insists the fed funds rate should be at least two points lower. Trump's urgency stems from rising interest costs on the $36 trillion national debt, projected to hit $1.2 trillion this year—more than any item besides Social Security and Medicare. With Treasury yields staying high, the budget deficit may near $2 trillion, over 6% of GDP.

- **CHANGES TO ECONOMIC FORECASTS:** *The Fed expects higher inflation and lower economic growth.* After 2.5% growth last year, U.S. GDP dipped slightly in Q1, largely due to businesses front-loading imports ahead of potential tariffs, which distorted trade data and complicated measurement. However, private domestic final purchases (PDFP)—a better gauge of underlying demand—still rose at a solid 2.5%. Consumer spending slowed, while business investment in equipment and intangibles rebounded.

  Back in March, the median forecast from Federal Reserve officials was slightly more optimistic: 1.7% growth, a 4.4% unemployment rate, and 2.7% PCE inflation. The updated projections suggest a weaker economic outlook, with both inflation and joblessness edging higher. The economic forecasts suggest lingering stagflation risks. Participants expect GDP growth to slow down to just 1.4% in 2025, marking the notable drop from last year (0.3 pp downgrade). The GDP is expected to stablize at 1.8% over the forecasting period.

  Inflation has come down from 2022 peaks but remains above the Fed's 2% target. PCE inflation was 2.3% in May, and core PCE (excluding food and energy) was 2.6%. Short-term inflation expectations have risen—largely due to tariff concerns—but long-term expectations remain anchored. Inflation is projected to reach 3% (a 0.3 pp increase from March's SEP). Core PCE, which excludes food and energy, was revised up to 3.1%, also a 0.3 percentage point increase. The unemployment forecast edged up slightly to 4.5%—0.1 points higher than in March and 0.3 points above the current rate.

  Labor market conditions remain strong. Average monthly job gains were 135,000 over the past three months, and unemployment holds steady at 4.2%. Wage growth has moderated but continues to outpace inflation. The labor market appears balanced, with no major inflationary pressure. The unemployment rate is projected to reach 4.5% by year-end and stay there through 2026.

The Fed released its updated "dot plot," signaling that two rate cuts remain likely by the end of 2025. However, projections for 2026 and 2027 were trimmed by one cut each, bringing the total expected reductions to four—equivalent to 1 pp. The dot plot reflected ongoing uncertainty among Fed officials regarding the path of interest rates. The median outlook points to a federal funds rate of about 3.4% by 2027. Notably, seven out of 19 officials now expect no rate cuts in 2025, up from four in March.

- **OUR TAKE:** *If the situation doesn't deteriorate further, we still see the Fed cutting rates in September, and possibly December,* while we consider a rate cut in July premature and unlikely at this stage.
- **MARKET REACTION AND IMPLICATIONS:** *Stocks hold steady as the Fed signals no rush to lower interest rates*. *In the fixed-income space,* the 2-year Treasury yield, after initially falling nearly 0.1 pp following the Fed's rate decision, rebounded and is now trading roughly unchanged on the day at 3.9%. 10-year Treasury yield rose to as high as 4.4% but then fell and now trades around 4.38%. *In the currency space,* The US Dollar Index dipped slightly after the Fed held rates steady and released its updated dot plot. The euro extended losses on Wednesday, briefly topping 1.1500 before retreating as a Powell-driven rebound pushed the Dollar Index toward the 99.00 mark. As for now, Dollar Index trades around 98.5. EUR/USD fell and trades around 1.147. *In the equity space,* stocks started the week on a cautious note amid escalating tensions between Israel and Iran, Stocks swung back and forth after the Fed held rates steady and Powell indicated the central bank would wait to assess the inflationary impact of Trump's tariffs before considering further cuts. The Dow, S&P 500, and Nasdaq all traded near the flatline.