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**Preview: Fed To Pause Its Easing Cycle,
On Independence and Strong Economy**

by

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26 January 2025

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Executive Summary

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- **Expected Decision:** *We expect the Fed to hold in January.* In line with consensus, we expect the Fed to maintain its target Fed funds range at 3.50% - 3.75% in December.

On forward guidance, the Fed will remain data-dependent and decide policy meeting by meeting. Chair Jerome Powell's firm defence of the Fed independence supports this approach, with any dissent likely confined to doves such as Stephen Miran and perhaps Chris Waller, a potential next Fed chair. Regarding *balance sheet policy*, in May last year the FOMC decided to slow down the pace of QT.

- **Policy Discussion:** *The Fed is expected to hold rates steady at this week's FOMC meeting after 75bp of cuts, with strong growth, low unemployment, elevated equity markets, and inflation still above target arguing for a pause.* Chair Jerome Powell has underlined this position by firmly defending the Fed independence amid pressure from Donald Trump and the beginning of a highly controversial legal investigation of the Fed, with any dissent likely confined to doves such as Stephen Miran and Chris Waller. Markets price little near-term action, and a Reuters poll shows most economists now expect the Fed to stay on hold through this quarter—and possibly until Powell's term ends in May—despite expectations for two cuts later in the year. The Fed will patiently wait to see whether the labor market weakens further and inflation softens or whether the recent strong GDP lead to a strengthening of the labor market and persistent inflationary pressures. So the likelihood and timing of additional rate cuts will be strictly data dependent.

Uncertainty around the data is reinforcing caution. The October–November government shutdown continues to partially distort inflation and labor indicators, while underlying job growth appears to have stalled outside a handful of sectors. At the same time, inflation pressures remain concentrated in a few services, and tariffs are not yet feeding meaningfully into prices, allowing disinflation forces such as lower energy costs, easing rents, and slower wage growth to continue. Liquidity conditions have stabilized following the Fed's renewed bills-buying program, reducing the need for further near-term action but leaving the door open to easing later in the year if labor market further weakens.

Key Picture: US Federal Reserve Forecasts – 2025-2028

	2025f			2026f		2027f		2028f		Longer Run	
	Latest Reading	December Report	Sep. Report	December Report	Sep. Report	December Report	Sep. Report	December Report	Sep. Report	December Report	Sep. Report
GDP (<i>real growth, y-o-y</i>)	2.2	1.7	1.6	2.3	1.8	2.0	1.9	1.9	1.8	1.8	1.8
Unemployment rate (% <i>y-o-y</i>)	4.4	4.5	4.5	4.4	4.4	4.2	4.3	4.2	4.2	4.2	4.2
PCE Inflation (% <i>y-o-y</i>)	2.7	2.9	3.0	2.4	2.6	2.1	2.1	2.0	2.0	2.0	2.0
Core PCE Inflat. (% <i>y-o-y</i>)	2.7	3.0	3.1	2.5	2.6	2.1	2.1	2.0	2.0	-	-
Federal Funds Rate (%)	3.75	3.6	3.6	3.4	3.4	3.1	3.1	3.1	3.1	3.0	3.0

Source: Federal Reserve 'Summary of Economic Projections' September and December 2025. Note: 1. GDP reading for Q2-2025; 2. Unemployment rate as of September 2025; 3. PCE and core PCE inflation as of September 2025; 4. Projections reflect the median of FOMC projection

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Analysis

- ✦ **EXPECTED DECISION:** *On January 28, we expect the US Federal Reserve's FOMC to keep its Fed funds range at 3.50% - 3.75%.* In December, Powell and eight members supported the move, while Miran pushed for a 50 bp cut and Goolsbee and Schmid preferred no change. It was Miran's third dissent and Schmid's second, echoing the committee's broader hawk-dove split.

Regarding *forward guidance*, the Fed will continue to be data-dependent regarding further policy changes with decisions being made meeting by meeting. Fed Chair Powell's firm defence of central bank independence amid presidential pressure and legal investigations of the Fed reinforces this stance, with any dissent likely limited to doves such as Stephen Miran and possibly Chris Waller, a potential next Fed chair.

Regarding *balance sheet policies*, the Fed in May last year decided to slow down the pace of QT from June. The Committee will continue reduce the size of its balance sheet made of Treasury securities, agency debt, and agency mortgage-backed securities holdings. Starting in April, the Committee slowed 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:** *The Fed is expected to hold rates steady at this week's FOMC meeting after 75bp of cuts, with strong growth, low unemployment, elevated equities, and inflation above target arguing for a pause.* Chair Powell has firmly defended Fed independence amid pressure from Donald Trump and a highly controversial legal investigation of the Fed, with any dissent likely limited to dovish members such as Stephen Miran and Chris Waller. Markets see little near-term action priced in, shifting attention to Trump's upcoming Fed chair nomination and incoming data. While one further rate cut this year remain our base case, it may be delayed if labor market weakness does not intensify. It is even possible that the one rate cut pencilled by the SEP doesn't occur if growth remains strong and inflation doesn't soften. A Reuters poll shows most economists now expect the Fed to keep rates on hold through this quarter—and possibly until Jerome Powell's term ends in May—marking a shift from expectations of an early cut.

The October-November government shutdown continues to partially distort key U.S. inflation data, delaying and skewing reports that the Fed relies on for policy decisions. Adjusted for possible overstatement, job growth appears to have stalled, with losses across most sectors outside government and a few services, strengthening the case for eventual easing. Inflation data suggest tariffs are not yet feeding meaningfully into prices, giving disinflation forces more room to work and providing the Fed with greater policy flexibility.

Inflation pressures remain concentrated in a few services, but overall price dynamics remain benign. Recent data suggest tariffs are not yet feeding meaningfully into prices, giving disinflation forces—such as falling gasoline prices, slowing housing rents, and easing wage growth—more room to work and providing the Fed with greater policy flexibility. This keeps the door wide open for one rate cut this year, with risks tilted toward a second one if the labor market cools further.

The Fed's renewed bills-buying program has eased liquidity strains, lifting securities holdings by a net \$55bn since mid-December and calming repo markets. While the effective fed funds rate remains slightly elevated, conditions have stabilized enough that no further liquidity action is likely for now.

Concerns over political interference are rising, with Donald Trump publicly pressuring Powell and legal and institutional tensions surrounding the Fed intensifying. While all economists expect rates to remain unchanged at the January meeting, opinions diverge beyond May, with a slim majority anticipating cuts once new leadership is in place.

The political attacks by the Trump administration against Powell and the Fed have backfired, especially the likely politically motivated legal investigation by Federal authorities of Powell and the Fed on the

controversial matter of cost overruns of the Fed headquarters renovation. Powell finally replied with strong words to the bullying by Trump and the DOJ investigation. Paradoxically the attack against Powell and the Fed has seriously backfired: the dovish Kevin Hasset is now less likely to be nominated as the new Fed Chair; the Supreme Court is likely to rule in favor of Governor Cook in the case where Trump attempted to have her fired; rate cuts are now less likely till at least when Powell is out of his Chair position; Powell may decide to stay in the Board after May once his role as Chair is over; and even leading Republican senators may keep the nomination of the new Fed Chair on hold until the legal saga against Powell is cleared.

- ✦ **MACROECONOMIC ANALYSIS:** *Revised data confirmed strong U.S. growth in the third quarter.* The US economy grew slightly faster than first estimated in the third quarter, with GDP revised up to a 4.4% annualized pace, the strongest since Q3 2023. The upgrade reflected stronger exports and business investment, alongside robust consumer spending of 3.5%, though underlying domestic demand eased slightly. The Atlanta Fed Nowcast of Q4 GDP growth is even stronger at 5.4%. But economists have noted increasingly uneven, “K-shaped” growth, driven by higher-income households and large firms amid tariff-related price pressures.

Inflation held steady at 2.7% in December, in line with expectations, suggesting price pressures remain contained despite staying above the Fed’s target. Core inflation eased to 2.6%, slightly below forecasts, while housing costs continued to push up the headline rate. Data showed inflation had moderated despite tariff concerns, though economists cautioned against over-interpreting the volatile release.

Job growth slowed in December, with non-farm payrolls rising by just 50,000, below expectations, while prior months were revised lower. Despite weak hiring, the unemployment rate edged down to 4.4% from 4.5%, helped by a rise in household employment and a shrinking labor force. Job gains were concentrated in services such as healthcare and food services, while retail lost jobs. Meanwhile, wage growth picked up, with average hourly earnings up 0.3% month-on-month and 3.8% year-on-year, pointing to continued underlying labor market tightness despite softer headline employment growth.

- ✦ **MARKET IMPLICATIONS:** At this FOMC meeting, Jerome Powell is expected to justify a pause, which could lend modest support to the dollar by dampening expectations of near-term rate cuts. As a result, EUR/USD is likely to remain range-bound, while a less dovish Fed could push USD/JPY higher, with the next sustained dollar move more dependent on weaker data than Fed rhetoric; however, USD/JPY rate will also depend on expectations that recent yen weakness may soon lead to FX intervention by Japanese policy authorities.

To put things into context, *in the fixed-income space*, the Treasury yields held firm Monday amid rising expectations of a Fed rate cut this week. As of January 24, the 2y *UST* trades rose by 3 bps to 3.60% (+12 bps y-t-d). The 10y *UST* edged up by 7 bps to 4.23% since the last meeting (+6 bps y-t-d). *In the currency space*, amid heightened geopolitical tension dollar fell sharply, sliding below 156 yen and heading for its worst week since June. As of January 24, and since the last meeting in December, the *dollar index* edged down by 0.9% to 97.27 (-1.1% y-t-d). *EUR/USD* rose by 1.1% to 1.18 since December meeting (+0.6% y-t-d). *In the equity space*, US stocks rose as investors were reassured after President Trump backed away from threatened tariffs on European allies linked to his Greenland push. As of January 24, S&P 500 rose by 0.4% to 6915.61 since the last meeting (+0.4% y-t-d).

✦ **APPENDIX (Macro Background):** *The better-than-expected GDP growth was mainly driven by a stronger exports and a smaller drag from inventories.* In Q3, the US economy grew by an annualized 4.4% (c: 4.3%; p: 3.8%), the fastest expansion since Q3 2023. Consumer spending rose (3.5% vs 2.5% in Q2). Government spending rose (2.2% vs -0.1%) and fixed investment increased (0.8% vs 4.4%). Exports surged (9.6% vs. -1.8%), while imports contracted fell (-4.4% vs. -29.3%). The economy grew 2.3% y-o-y in Q3 2025, higher than previous estimate of 2.1%.

Composite PMI edged up, indicating a slight pickup in activity, though growth remained weaker than in the second half of 2025. In January, the S&P Global US Composite PMI rose to 52.8 (p: 52.7). The Services PMI stood at 52.5. The Manufacturing PMI accelerated to 54.8 (p: 53.6).

The US job growth slowed more than expected in December. In December, the unemployment rate edged down to 4.4% (c: 4.5%; p: 4.5%). NFP added 50K (c: 60K; p: 56K). Wage growth increased by 3.8% in November (p: 3.9%). The U-6 unemployment rate, which includes those marginally attached to the labour force and those working part-time for economic reasons, eased to 8.4% (p: 8.7%).

Core inflation undershoots expectations. In November, the personal consumption expenditures (PCE) – the Fed’s preferred inflation gauge – increased to 2.8% y-o-y (c: 2.8%; p: 2.7%). The core-PCE – which excludes volatile energy and food prices – rose to 2.8% y-o-y (c: 2.8%; p: 2.7%). In September, headline and core inflation rate stood at 2.7% y-o-y (c: 2.7%) and 2.6% y-o-y (c: 2.7%).



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