US Fed remains inclined to cut rates, but is in no hurry

After 100bp of rate cuts, Fed Chair Powell suggests policy remains restrictive – even if inflation remains elevated they will merely "maintain" policy restraint for longer. This indicates an inclination to cut rates closer to neutral, but no change is likely before June

US Fed Chair Powell testifying before the Senate Banking Committee

Fed signals little prospect of any further rate cuts before summer

Much was made of the lack of reference to the three "Big Ts" within the Federal Reserve's Monetary Policy Report published yesterday. Tariffs were mentioned twice while President Trump nor the word "trade" featured at all. Well, all three failed to be worthy of inclusion in Fed Chair Jerome Powell's testimony to the Senate Banking Committee. Instead, we get a rehash of the press conference following the Fed's decision to leave rates on hold in January.

Economic activity and the labour market were described as "solid" while inflation remains "somewhat elevated". In this regard he suggests that the jobs market is "not a source of significant inflation pressures" and since "longer-term inflation expectations appear to remain well anchored" they appear relaxed with the current stance of monetary policy. He does state that after 100bp of rate cuts "our policy stance is now significantly less restrictive" and with the economy performing well "we do not need to be in a hurry to adjust our policy stance".

There is still a bias to cut again with the phraseology "we know that reducing policy restraint too fast or too much could hinder progress on inflation. At the same time, reducing policy restraint too slowly or too little could unduly weaken economic activity and employment." Moreover, "if the economy remains strong and inflation does not continue to move sustainably toward 2 percent, we can maintain policy restraint for longer" – no mention of reversing course and hiking rates!

Chair Powell was asked about trade policy and tariffs, but merely stated that the case for free trade makes logical sense, but can fall down if other large countries don't play by the rules – clearly a dig at China. Nonetheless, he adds that it isn't the Fed's job to make nor comment on trade policy. They can only react to economic data as they see it.

Two rate cuts remains the view for second half 2025

There is no set path though with the data flow deciding if, and when, they do cut further – remember their latest forecasts from December suggested the committee viewed two cuts this year and two next was the most likely path forward.

President Trump's policy mix of light touch regulation and lower taxes, coupled with immigration controls and the threat of tariffs may keep growth and inflation more elevated. This indicates little prospect of a rate cut before June. We are forecasting two rate cuts in the second half of the year though with cooler job creation and wage pressures, coupled with softer housing inflation helping to partially offset some of the impact from possible tariffs. This should give the Fed the scope to keep edging monetary policy closer to a "neutral" footing.

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