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Situation analysis January 29, 2025

Fed keeps interest rates steady, retains expectations of further easing in 2025

Key takeaways

- The U.S. Federal Reserve (Fed) maintained its policy interest rate range of 4.25%-4.50%, with the intent of bringing inflation closer to its 2% target.
- The decision was expected, and Chairman Jerome Powell emphasized "we don't need to be in a hurry" to adjust rates given economic strength and still-elevated inflation.
- The Fed's median projections from December call for 0.50% of rate cuts in 2025, which generally aligns with interest rate market pricing.

The Federal Reserve held its target federal funds interest rate in a range of 4.25%-4.50% today following its regularly scheduled two-day meeting. Economists and investors widely anticipated today's outcome after the Fed cut rates by a total of 1% starting in September 2024. The Fed's statement noted solid economic activity and labor market conditions, a low and stable unemployment rate, and that "inflation remains somewhat elevated" in its decision to keep rates unchanged.

During Chairman Jerome Powell's press conference, he said, "We see things as (being) in a really good place for policy, and for the economy." He added some measures of shelter costs and other observable, market-based service prices have been coming down. He differentiated between his view that while this suggests further progress on inflation is coming, "actually seeing further progress" in the data is different and remains what they're looking for. These comments support the Fed's previous expectations that inflation should continue decelerating and corroborate its December projections for two rate cuts later in 2025.

First paragraph of Fed statement

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.

Sources: Bloomberg, Federal Reserve, 1/29/2025

Aggressive policy tightening in the form of rate hikes between early 2022 to mid-2023 helped drive the Core Personal Consumption Expenditures Price Index (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% year-over-year in 2022 to 2.8% in November.

The Fed is currently allowing to runoff, or mature without replacement, up to $25 billion per month in Treasuries and $35 billion per month of mortgage bonds currently in the Fed's inventory. This pace reflects a drop from the previous $60 billion per month in Treasuries as of June 2024. Many had anticipated this runoff would conclude in March 2025 but have revised expectations to June 2025 or later. Slower or no balance sheet runoff improves market liquidity, which refers to the amount of money readily available to buy goods, services and financial assets in an economy. Strong liquidity can also provide cushion against unforeseen financial market shocks. Shorter-term liquidity measures remain constructive for now.

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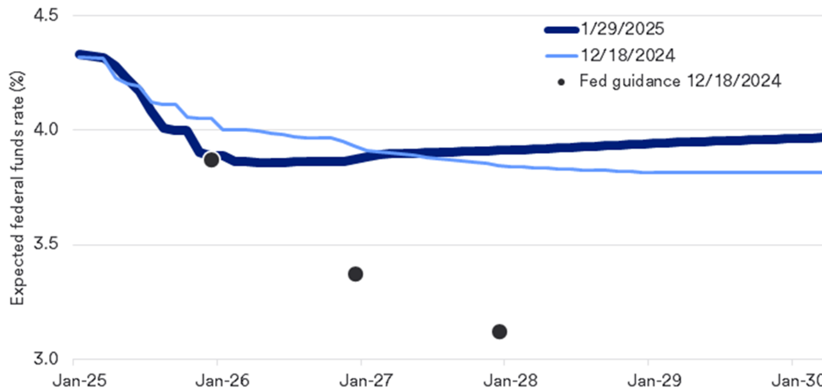
Market pricing of the expected path of the federal funds rate

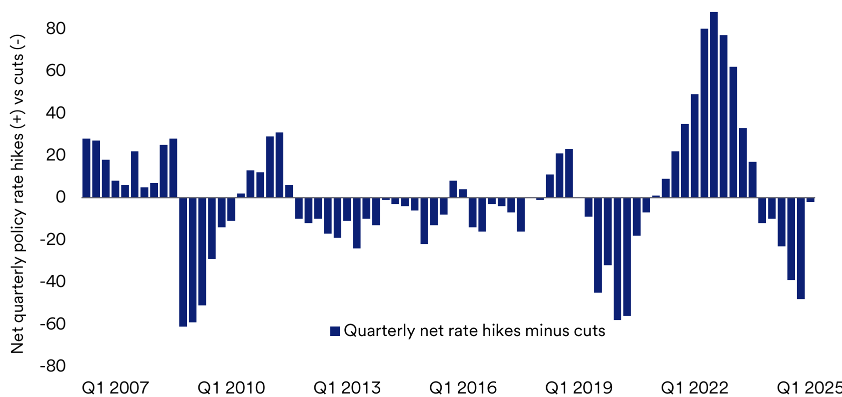


Sources: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg; 12/18/2024-1/29/2025

Stock prices fell slightly Wednesday, but despite volatility, ended the day little changed versus when the Fed's communication began. Large stocks, represented by the S&P 500, fell 0.47% while small stocks fell 0.25%. Treasury bond yields rose slightly for certain maturities. Ten-year Treasury bond yields were flat, remaining at 4.53%, while two-year Treasury yields rose 0.02% to 4.21%.

Monetary policy, defined as central bank target interest rates, remains restrictive in most geographies around the globe. However, policy has been easing overall, with central bank rate cuts exceeding hikes starting in the fourth quarter of 2023. Several other major central banks in addition to the Fed have already or are expected to cut rates this year, including the Bank of England, European Central Bank, Bank of Canada and the Reserve Bank of Australia.

Global net central bank rate hikes (net hikes minus cuts), quarterly



Sources: U.S. Bank Asset Management Group Research, Factset; 4/1/2006-1/29/2025

We retain a constructive outlook for diversified portfolios due to solid corporate profits, a solid economic growth trajectory and our expectation for further easing of global monetary conditions. Economic data is once again surprising to the upside, although with more dependency on the labor market and wages, which we continue to monitor closely. Consensus economist forecasts call for a smooth and slower trajectory of real (inflation-adjusted) growth settling near 2% in coming quarters. In aggregate, consumer activity remains near normal historical levels, though driven disproportionately by wealthier cohorts. Moderating medium-term inflation trends remain clear despite stimulative fiscal

policy in the form of deficit spending and increasing government debt. We will keep you informed of our views as incremental data becomes available and as we update our assessment of market conditions.

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