

Fed in no hurry to cut rates

The first meeting of the US Federal Reserve Open Market Committee (FOMC) for 2025 saw the central bank leave policy on hold. The target range for the Fed funds rate was maintained at 4.25-4.50%. The decision by the FOMC to leave rates unchanged was unanimous and very much in line with market expectations. This was the first time in four meetings that the Fed did not cut interest rates, having previously reduced rates by 100bps over the course of its last three meetings in 2024.

The January FOMC statement contained relatively limited changes from its December edition. The Fed continued to state that incoming macro data indicates that “economic activity has continued to expand at a solid pace”. It did alter its characterisation of the labour market, noting that the unemployment rate “has stabilised at a low level in recent months” whereas in December it commented that “conditions had generally eased”.

There was also a tweak to the inflation language in the statement, which in isolation suggested a more hawkish tone. It dropped the reference to inflation making “progress toward the Committee’s 2% objective”, while retaining its view that “inflation remains somewhat elevated”.

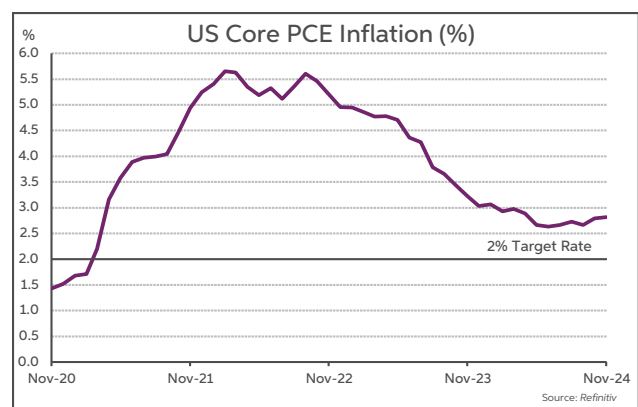
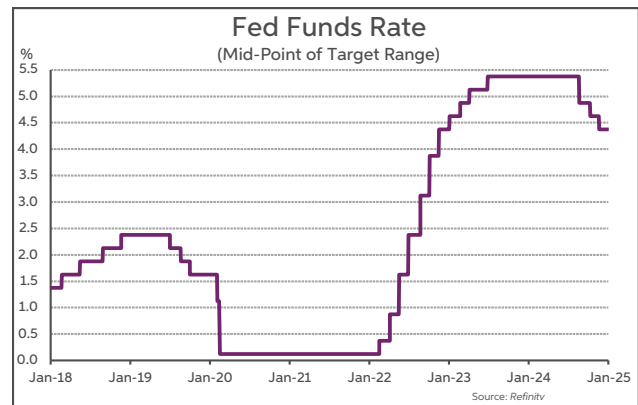
However, in the post-meeting press conference, Chair Powell downplayed the significance of this amendment to the inflation language. He characterised the change as a “little language clean-up” rather than any sort of policy signal. Generally, his comments during the press conference struck a balanced tone. When asked if a rate cut was on the table for its next meeting in March (18th/19th) he kept his options open, although he gave no suggestion that the Fed was actively contemplating this. He said that the FOMC’s view is that its monetary policy is “well positioned” and the economy “is in quite a good place”.

In the context of any further easing in policy from the Fed, Chair Powell stated that the central bank will continue to focus on “seeing real progress on inflation” or “some weakness in the labour market” before it will consider easing rates further. He summed up the Fed’s policy outlook by stating that “we feel we don’t need to be in a hurry to make any adjustments”.

Indeed, this view was already clearly illustrated in the Fed’s most recent interest rate projections (i.e. dot plot) released at the December FOMC. The ‘dots’ indicate a more gradual pace of rate cuts. The median projection is that rates will decline to a 3.75-4.0% range by end-2025. In other words, a further 50bps of rate cuts this year, compared to its previous projection of 100bps of rate cuts. Rates are envisaged to be cut by a further 50bps in 2026 and by 25bps in 2027, falling to a 3.0-3.25% range.

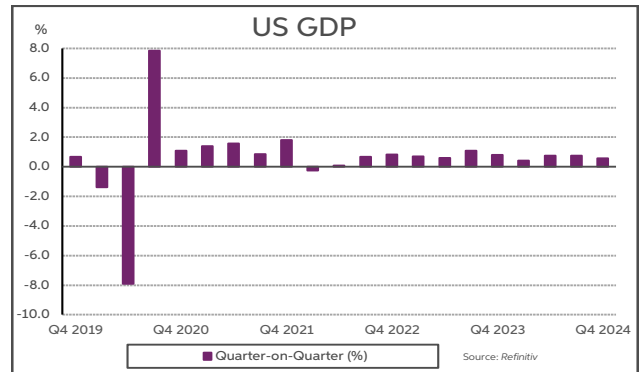
In terms of market expectations for this year, current pricing is aligned with the Fed’s projections. Futures contracts are consistent with 50bps of rate cuts in 2025 which would see official rates will end the year in a 3.75-4.00% range. The first rate cut of the year is not fully priced-in until June.

Overall, the Fed has clearly stated that while it retains an easing bias, it is in no rush to cut rates further. At this point in time, the central bank is comfortable that it has reduced interest rates to an extent that “policy is meaningfully less restrictive” and is “well positioned” while it assesses the evolving economic outlook and the implications of any significant changes in US trade and fiscal policy under the Trump administration.



US economy enters 2025 on a firm footing

The US economy continued to perform very strongly in 2024. GDP expanded by 2.8% in the year, marginally below the 2.9% increase seen in 2023. Consumption and a sharp rise in government spending were the main drivers of growth throughout 2024. Meantime, a strong increase in non-residential investment also boosted GDP, although this was undercut by a decline in residential activity. In terms of net trade, imports have continued to grow at a faster pace than exports, resulting in a negative contribution from net trade to GDP in 2024.

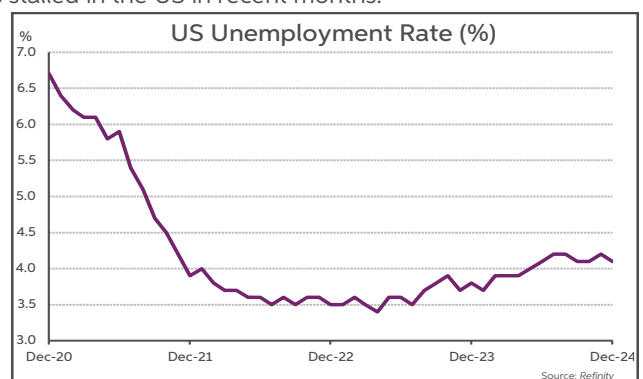


Meanwhile, the limited survey data available for January have been somewhat mixed. Overall though, they suggest the economy maintained solid momentum at the start of the year. Having been in contraction territory since last July, the manufacturing PMI edged up to 50.1 in January, indicating a stabilisation of conditions in the sector. However, the services PMIs declined to 52.8 in the month, consistent with a continued expansion in activity, albeit at a slower pace. Elsewhere, having increased markedly in Q4, both the Michigan and Conference Board measures of consumer confidence deteriorated slightly in January. In contrast, homebuilder sentiment continued to trend upwards at the start of 2025.

In terms of the labour market, conditions have softened, albeit the data have been somewhat volatile. The unemployment rate was at 4.1% in December, having oscillated between 4.1-4.3% since June. This compares to a range of 3.7-3.9% in Q1. Meanwhile, the pace of payroll expansion has slowed. Overall, payrolls rose by 2.2m in 2024, having increased by 3m in 2023. Furthermore, the average pace of payroll expansion declined from 267k per month in Q1, to 148k, 159k and 170k per month, in Q2, Q3 and Q4, respectively. At the same time, there are signs that labour demand is waning. The number of job openings stood at 8.1m in November, up from a low of 7.4m in September, but down from 8.9m at the start of 2024. Amid the softening in labour demand, average earnings growth has slowed but remains elevated. It printed at +3.9% y/y in December, just below the +4.0% y/y rate in October and November, and the +4.4% rate registered in January.

The inflation data have also been somewhat noisy in recent months. Headline CPI inflation had been trending lower before it rose throughout Q4. It printed at 2.6% in October and 2.7% in November, before jumping to 2.9% in December. Likewise, having slowly dissipated in the first seven months of the year, to a low of 3.2% in July and August, core-CPI increased to 3.3% in September and stayed at that level until it inched back to 3.2% in December. Similarly, core-PCE had been falling slowly, edging down to 2.6% in June, its lowest level since March 2021. However, it rose to 2.7% in July and remained at that level in Q3, before rising to 2.8% and staying there in October and November. Thus, it is clear the disinflationary process stalled in the US in recent months.

To summarise, the US economy came into 2024 in rude health, on the back of strong growth, a tight labour market and falling inflation. Furthermore, the economy maintained strong growth momentum throughout last year. Meantime, a clear softening in the labour market (notwithstanding the volatility in the data), and slowly waning inflation also allowed the Fed to cut rates by 100bps in 2024. All-in-all then, the economy entered 2025 on a firm footing. Against this backdrop, the IMF expects the US economy to stay in robust health, with GDP rising by 2.7% this year and by 2.1% in 2026.



However, it should be noted that the disinflationary process has lost steam in recent months. At the same time, the unemployment rate remains low and consumer spending is solid, indicating that there is a risk that inflationary pressures could accelerate once again. This suggests the Fed will have to proceed cautiously in setting rates in 2025. Longer-term, there remains a level of uncertainty surrounding US economic policy which is clouding the outlook. President Trump has proposed a number of policies (tax cuts, restricted immigration, trade tariffs) which are likely to add significantly to an already yawning fiscal deficit, and to inflation. The policies may also restrict the level of rate cuts from the Fed. However, to date, the policy agenda has not been clearly outlined.

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