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Future Fed policy decisions still data dependent after 25 bp cut

The Bottom Line:

- The 25 basis point Fed rate cut today was widely expected. The economic backdrop has been too resilient, and inflation too sticky, to justify a repeat of the (larger than "normal") 50 basis point initial cut in September but labour markets have shown enough, albeit very gradual, signs of cooling to argue that interest rates are still higher than they need to be to get inflation back fully to the 2% objective.
- The Fed continues to signal that more interest rate cuts are likely coming, but the timing (and end destination) remain uncertain. Our own base-case assumption remains two additional 25 basis point cuts from the Fed in December and January before pausing at a 4% to 4.25% range for the rest of 2025 with interest rates needing to stay at relatively high level to offset the inflationary impact of an unusually large government budget deficit.

The Details:

- The Fed's policy statement was little changed, reiterating that the economic growth backdrop is still resilient but that labour market and inflation have still shown signs of cooling (even if not as quickly as previously expected.)
- Policymakers dropped a reference from September that the committee has "gained greater confidence" that inflation is moving back to the 2% target - Chair Powell dismissed the significance of that omission, saying that it is still true, the Fed just didn't feel a need to repeat it. But inflation has also surprised on the upside since September.
- Chair Powell reiterated that policy is still on a path back to 'neutral' (implying more rate cuts are still planned) but the pace to get there, and the destination (the level of interest rates at the end of the easing cycle) remains uncertain and highly data dependent.

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- Powell acknowledged recent upside inflation surprises, but also argued that downside risks remain and that there are risks both that the Fed could need to cut rates more slowly (if inflation continues to surprise on the upside) or more quickly (were labour markets to deteriorate more quickly)
- As expected, Powell did not comment on the potential impact of monetary policy from this week's federal election, beyond reiterating that the Fed needs to respond to effects of government policy changes on inflation and labour markets when they happen.