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EcoFlash

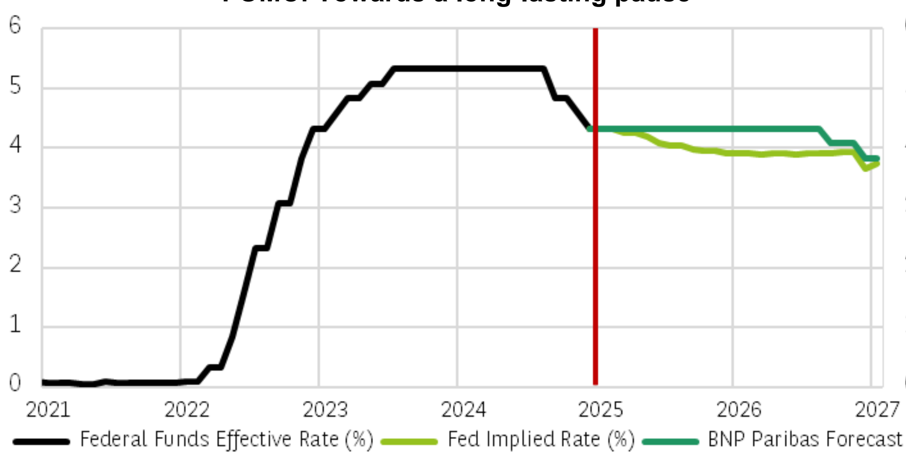
FOMC: Time for a Pause

The first FOMC meeting of 2025 (28-29 January) should result in the target rate being held at +4.25% - +4.5%. In our view, this would mark the beginning of a pause lasting until mid-2026, due to the anticipated pick-up in inflation that would result from Donald Trump's economic policy.

1. The Time for Rate Cuts Appears to Be Over: Last September, the Fed initiated a monetary easing cycle, justified by the progress of disinflation, the softening of the labour market and the willingness to shield economic growth. Since then, developments on these three fronts have not confirmed these trends: disinflation has stalled, non-farm payrolls have rebounded, and economic activity has picked up somewhat. Thus, for its first meeting of 2025, the conditions for further rate cuts no longer appear to be met. As a result, the Fed should hold its target rate at +4.25% - and +4.5%.

2. The Stage Has Been Set: Pre-blackout interventions by FOMC members stressed that cautiousness was now warranted. John Williams, the influential New York Fed President, stated that current monetary policy was in a ‘very good position’ and that the committee could ‘take the time to analyze the incoming data’. More offensive, Cleveland Fed President, Beth Hammack - the only dissenting voter in December - declared that there was still an ‘inflation problem’ and that the Fed could be ‘very patient’ when it comes to rate cuts. As a result, the probability of a hold rose to 99.5% in the Fed funds futures market.

FOMC: Towards a long-lasting pause



Source: Bloomberg, BNP Paribas

3. Towards a Lasting Pause: The loss of disinflation momentum should be followed, according to our forecasts, by a pick-up in inflation associated with the implementation of Donald Trump's economic policies (tariffs, immigration). As a result, January's pause would turn into a lasting monetary status quo, with the target rate held at +4.5% (upper bound) throughout 2025.

Our scenario differs from that of the financial markets (see chart), which remain more bullish on growth and less worried about price stability (as illustrated by the moderate increase 5-year in the 5-year inflation). Therefore, as of January 24, implied rates from futures market suggest one rate cut in 2025 (-25bps) and a 67% probability of a second cut. As for the Fed, since no updated dot plots will be released, the clues about future movements will be sought in the statement and the press conference. The combination of recent developments and uncertainty regarding the outlook should prompt the central bank to emphasize the data-dependent approach and maintain all options open.

4. Chronicle of a Foretold Clash? Jerome Powell, who is entering his final full year at the head of the Fed, will undoubtedly have to answer questions on political issues, notably on the impact of anticipated upcoming economic measures on monetary policy and on potential political interference. The minutes of the December meeting already disclosed a divergence between the official message ('we don't guess, we don't speculate, we don't assume') and the reality of the incorporation of the presidential election into the policymakers' analyses. Once inaugurated, Trump declared himself again more competent than the Fed when it comes to interest rates, and ready to express them his disagreements about monetary policy. However, this should not push the FOMC to be more accommodative than necessary.

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