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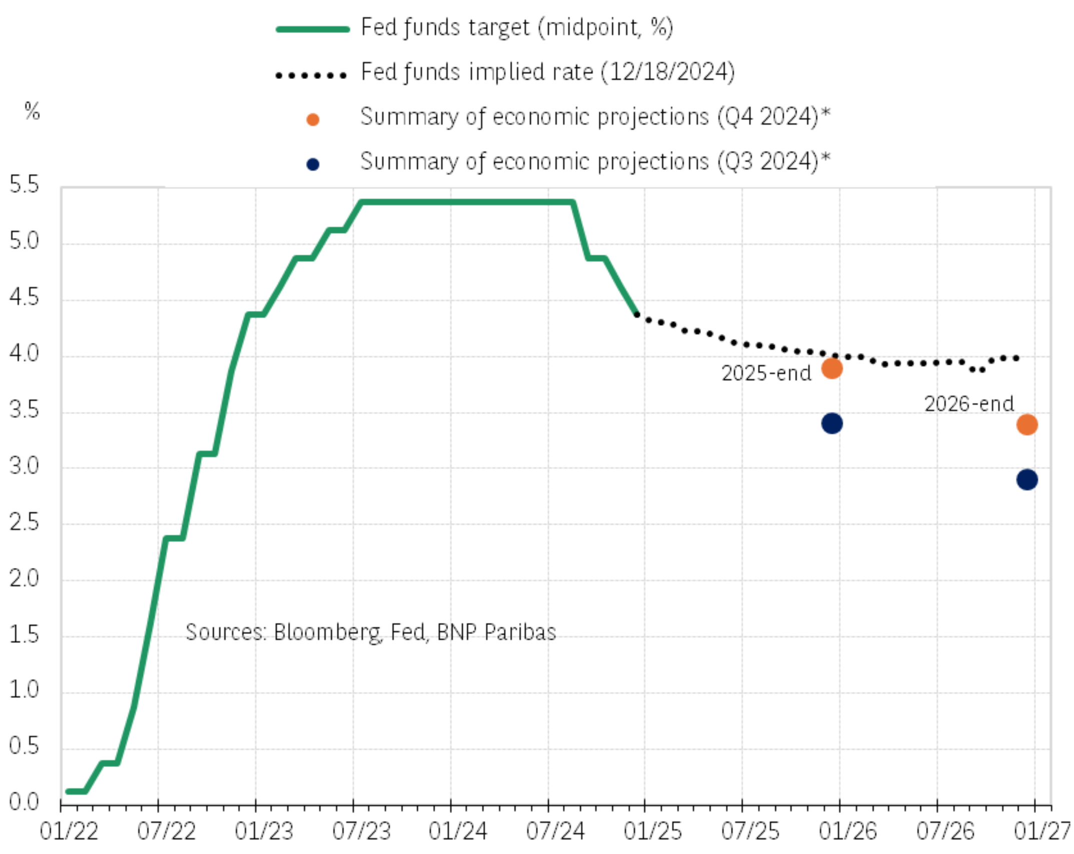
EcoBrief

United States - FOMC: End of the cutting cycle?

The Fed ended the year with a reduction in its target rate (-25 bp), which now stands at +4.25% to +4.5%. Meanwhile, median expectations by committee members of the number of cuts fell from four to two for 2025. The response from the financial markets was abrupt.



* Dot Plots: median projection of the Fed on policy rate

The Last Dance: This Christmas cut, which may not have happened by Jerome Powell's own admission (as it was a "close call"), is justified by a labour market rated as less dynamic than before the pandemic. However, according to our central scenario, this will be the last in this easing cycle due to the increased inflationary risk. The median of FOMC member projections sets the interest rate target at +4.0% (upper limit) at the end of 2025, compared to +3.5% in the latest Summary of Economic Projections. Four members anticipate it above this figure compared to five below it. This change reflects the upward revision of median inflation expectations, from +2.1% to +2.5% for the PCE in 2025, with a significantly higher number of members worried about the uncertainty and upward risks surrounding this latter point.

Elephant in the Room*:* The Fed wants to avoid suspicion of political bias. Jerome Powell limited the justification for the slower pace expected for rate cuts to the latest developments in growth, inflation, and employment, and to the required caution as the neutral rate approaches. He only just acknowledged that "economic policy uncertainty" could have played on "uncertainty around inflation" and that "some" members had included conditional policy assumptions in their projections. Nevertheless, this renewed cautiousness, wanting to appear independent of Trump's election, seems to be a first step towards effectively stopping interest rate cuts once the implementation of Trump's economic agenda legitimises it.

Sudden market reaction: This prelude to a monetary policy more restrictive than anticipated was negatively received by the financial markets. The S&P 500 closed at -2.95%, while the EUR/USD rate fell from 1.05 to 1.04, pulled down by the anticipation of a less favourable interest rate differential for the euro.

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