Fed Makes Another Cut—Now, a Pause?

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Authors	Date	Topic
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Key takeaways

- We expect the Fed to continue its vigilance in monitoring inflation as the fight might not be over just yet.
- The market currently expects the Fed to cut rates to somewhere between 3.75% and 4.00% during 2025.
- Incoming growth and inflation data along with fiscal stimulus details will be key determinants of future rate decisions.

Today, the Federal Open Market Committee (FOMC) announced a widely expected cut of 25 basis points (bps; 100 bps equal 1.00%) in its key interest rate, the federal funds rate, lowering the rate to 4.25–4.50%. It was broadly welcomed as a sign of the Federal Reserve's (Fed's) willingness to bring inflation-adjusted yields down further. From here, however, the interest rate path is less clear, with no future cuts expected before March 2025. Incoming growth and inflation data along with more details on fiscal stimulus will be the main determinants for future rate decisions.

The U.S. inflation rate has stayed slightly elevated compared with the Fed's 2.0% target level. While the Fed's preferred measure of prices, the Personal Consumption Expenditures (PCE) Price Index, has been stable over the past several months, the core PCE Price Index (which excludes food and energy) has remained slightly elevated, at 2.8%. Capital goods prices are no longer a deflationary force, although some of the stickier services prices, like rents, have rolled over.

Key data points we're monitoring concern the robustness of the labor market—the key challenge for the U.S. economy moving forward. After a weaker October reading, monthly nonfarm payroll numbers recovered strongly in November and job openings have increased again. The unemployment rate picked up slightly in November, to 4.2%, though consumers' real income has remained robust, benefiting from the latest inflation decline. Forward-looking U.S. growth indicators point to gradually increasing economic growth, toward around a 3% rate of real growth (real growth calculations provide the value of all goods and services an economy produced while accounting for price fluctuations).

We expect the Fed to remain vigilant in monitoring inflation as the fight might not be over just yet. For 2025, the interest rate market currently expects the Fed to cut rates to somewhere between 3.75% and 4.00% over the course of the year. A lot will depend on how aggressive U.S. fiscal policy turns out to be.

We continue to like equities—especially the cheaper parts of the U.S. equity market and parts of international markets that benefit from further Chinese stimulus and aggressive central bank rate cuts. We expect the equity rally to broaden and believe that any relief from perceived looser monetary policy would likely support equity prices in the medium term. **The outlook for higher-yielding bonds remains favorable as a U.S. recession looks unlikely.**