Fed Watch

Fed likely to hold rates steady in June as it awaits clearer signals from data

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Recent softness in sentiment is not yet enough to shift policy as solid demand and stable jobs data support a continued pause

- **The Fed left the federal funds rate unchanged at 4.25-4.50% and reiterated that a wait-and-see approach remains the most appropriate response to the persistent uncertainty.** The policy statement reaffirmed that "economic activity has continued to expand at a solid pace" despite the "swings in net exports [that] have affected the data"—a clear reference to the 0.3% GDP contraction in 1Q25 that was driven by a historic surge in imports. This framing suggests the Fed remains confident in the strength of underlying domestic demand. The statement continued to describe labor market conditions as "solid," and maintained a long-held cautious tone on inflation, which "remains somewhat elevated" despite March's muted core inflation figures. As we argued earlier this week (see), a single month of softer data was unlikely to shift the Fed's tone, particularly with tariff-related inflation still expected to feed into upcoming inflation reports. By stating that "the risks of higher unemployment and higher inflation have risen," the Fed paves the way for a more refined adjustment to the Fed's forward guidance in future meetings if needed. For now, however, the statement continues to emphasize that the Fed remains in wait-and-see mode, reiterating that it "is prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals."
- **During the Q&A, Powell summarized the current state of the US economy by saying the data portray "a healthy economy albeit one that is shrouded in some very downbeat sentiment."** But for now, the Fed does not yet see evidence that would justify rate cuts in the near term. Some reporters pressed Powell on why the Fed isn't weighing the recent deterioration in soft data—such as consumer and business sentiment surveys—more heavily when considering the case for preemptive easing. Apart from considering that the link between soft indicators and hard data like spending or hiring has not been particularly strong historically, Powell said the Fed is watching these soft indicators closely, but he implied that any dovish shift is unlikely to come from soft data alone unless hard data weakens materially or long-term inflation expectations drift meaningfully away from the 2% target. Powell noted that "the risks of higher unemployment and higher inflation appear to have risen, but they haven't materialized yet, [i.e.,] they're not really in the data yet," underscoring the degree of uncertainty and the rationale behind the Fed's decision to remain on hold.
- **He continued to signal that the Fed is not "in a hurry" to change its stance and that policy is well-positioned to respond to either persistent inflation or weak growth.** The Fed is not facing yet a situation "where [they] can be preemptive because [they] actually don't know what the right response to the data will be until [they] see more data." Powell did acknowledge the possibility of a scenario in which its dual mandate goals—maximum employment and price stability—become in tension. If that occurs, he said, the Committee would consider "how far the economy is from each goal and the potentially different time horizons over which those respective gaps would be anticipated to close." If that were to occur, "difficult judgment" would be required by Fed members, but even then, absent a major economic crash, we lean to think that the Fed

would more likely prioritize its inflation mandate, particularly given Powell's reminder that "without price stability we cannot achieve the long periods of strong labor market conditions that benefit all Americans."

- **Powell did not completely close the door to potential rate cuts though, and reiterated that the Fed has a "record of [being able to] move quickly when that's appropriate."** He said that in the potential outlooks ahead "there are cases in which it would be appropriate for [them] to cut rates this year." While these remarks affirm that the Fed remains flexible and data-driven, the Fed—like most analysts, us included—appears to be operating under a baseline in which tariffs will ultimately push inflation higher. If that materializes, Powell acknowledged, the Fed "won't see further progress toward [their] goals." This makes it more likely that the current pause will extend longer than financial markets are currently pricing in. Even when the inflation impact materializes, uncertainty will persist, as the Fed would then face the additional challenge of determining whether the inflationary effects of tariffs are "short-lived" or "more persistent"—a judgment that will likely require several months of data to confirm. The Fed also has in mind the possibility of positive negotiations between Trump and its most affected trade partners which "has the potential to change the picture materially" and avoid harming the economy, but Powell once again noted "we simply have to wait and see."
- **In sum, today's announcement reinforces our view that the Fed is unlikely to deviate from its wait-and-see approach and is likely to hold rates steady again when it meets in June.** We think it will be difficult for the data available before the June meeting to shift the balance of risks decisively toward the employment side of the mandate. Only one payroll report will be released before then, and the second estimate of 1Q25 GDP is unlikely to revise the picture significantly. Two separate reports of industrial production and retail sales within the next five weeks will be closely watched for signs that consumption or manufacturing have deteriorated for the worse, but we currently see that outcome as unlikely. While "uncertainty is extremely elevated," the unemployment rate has been moving sideways around a level consistent with maximum employment. Thus, the Fed "can afford to be patient as things unfold," i.e., "there's no real cost to [their] waiting at this point." Looking further ahead, if economic activity does not deteriorate meaningfully in 2H25, it will be difficult for the Fed to justify rate cuts given the likely delay in inflation's convergence to target. Therefore, while we see a June hold as very likely, we believe rate cuts also seem unlikely soon after then. For now, until the tariff shock unfolds, patience will remain the Fed's guiding principle. Attention now turns to incoming data to assess whether this cautious pause could extend deeper into the second half of the year.

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