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Fed pauses the rate-cutting cycle as the outlook improves

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Powell signals the Fed is comfortable staying on hold for some time amid lingering tariff-related inflation risks

As widely expected, the FOMC kept the target range for the federal funds rate unchanged at 3.50–3.75% amid strong growth and signs of stabilization in the labor market. The decision to pause rate cuts enjoyed broad support, with only two dissenters among voting members—Miran and Waller, who preferred a 25bp rate cut. The policy statement included several adjustments to the Committee's assessment of economic conditions. Stronger-than-expected momentum through 4Q25, as signaled by recent hard data, led the FOMC to upgrade its view of economic activity, noting that it has been expanding at a "solid" pace rather than at a "moderate" one. While this continues to contrast with a still-cautious assessment of the labor market—where job gains were described as having "remained low"—the Committee also noted that the unemployment rate "has shown some signs of stabilization." On inflation, the statement was largely unchanged, reiterating that inflation "remains somewhat elevated." Reflecting both the improved growth backdrop and signs of labor market stabilization, the FOMC removed its previous judgment that "downside risks to employment rose in recent months," a change consistent with today's decision to pause. But forward guidance was left unchanged and continues to emphasize a cautious, data-dependent approach that leaves the door open to additional easing later this year, with the Committee reiterating that, "in considering the extent and timing of additional adjustments," it "will carefully assess incoming data, the evolving outlook, and the balance of risks."

In his Q&A, Powell noted that while upside risks to inflation and downside risks to employment remain, both have diminished, allowing for a wait-and-see approach. He was particularly emphatic in anchoring the pause to stronger-than-expected activity data over recent quarters, which he said imply a "clear improvement in the outlook for growth" that "should matter for labor demand and for employment over time." Powell also reiterated the "signs of stabilization" in the labor market highlighted in the statement. Taken together, these developments leave the Fed "well positioned […] to let the data speak." After last year's three rate cuts, he argued that monetary policy is now "sort of loosely neutral or […] somewhat restrictive." In this context, Powell did not close the door to a potential resumption of the rate-cutting cycle, acknowledging that there remains "some tension between employment and inflation [...], but is less than it was." As for potential triggers to resume easing, Powell pointed to scenarios in which incoming data are consistent with the Fed's expectation that tariff effects flowing through goods prices will peak and fade, which would tell the Fed they "can loosen policy", or that suggest the labor market is not stabilizing, which also would be "an argument for loosening." Powell acknowledged that inflation excluding tariff-affected goods is close to target[1], while also emphasizing that "if you look at services you do see ongoing disinflation." However, he closed the press conference by warning that the inflation outlook still faces latent upside risks, noting that "a lot of companies in the middle [of value chains] are pretty committed to passing" tariff-related cost increases through to consumer prices. That process may take time to unfold, reinforcing the need to "keep [their] eye on inflation and not declare victory prematurely."

Today's decision and Powell's Q&A reinforce our view that the Fed is comfortably settled into a pause that is likely to extend through the first half of the year. The combination of a stronger assessment of growth, a more balanced view of labor market risks, and lingering tariff-related inflation risks suggests that most at the Committee will continue to see little urgency to resume easing in the near term. With policy now close to neutral and risks to both sides of the mandate still in tension but also having diminished, the Fed appears content to wait for clearer evidence before making its next move. In this context, we do not expect rate cuts at either of the remaining meetings under Powell's tenure as Chair. An earlier resumption of easing would likely require a more decisive weakening of the labor market—such as a sudden rise in layoffs pushing the unemployment rate higher—or a faster-than-expected dissipation of tariff-driven inflation pressures on goods. Absent such developments, the Fed is likely to maintain a patient, data-dependent stance for several months. Looking further ahead, we continue to expect that conditions will allow the Fed to deliver two additional rate cuts in the second half of 2026, bringing the policy rate to a 3.00-3.25% terminal rate range.

[1] "Core PCE inflation is running just a bit above 2% [excluding] the effects of tariffs on goods."

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