Situation analysis

May 7, 2025

Fed holds rates steady while investors anticipate three to four cuts in 2025

Key takeaways

- The U.S. Federal Reserve maintained its policy interest rate range of 4.25%-4.50%, with the intent of bringing inflation closer to its 2% target.
- Fed Chairman Jerome Powell highlighted the risk of rising unemployment and rising prices that may result from tariffs but cited resilient economic data as justification to hold rates steady for now.
- Investors now anticipate three to four rate cuts in 2025, compared with one to two expected at the beginning of the year.

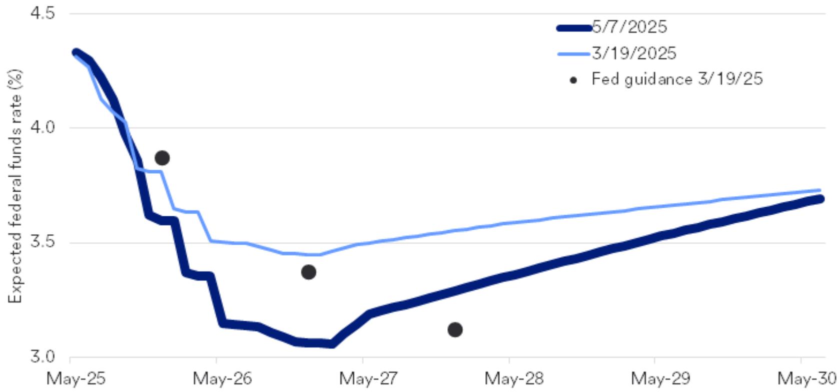
The Federal Reserve (Fed) held its target federal funds interest rate in a range of 4.25%-4.50% following its regularly scheduled two-day meeting, a widely anticipated outcome. The Fed has held rates steady since previously cutting rates by a total of 1% in 2024's second half. The updated official statement noted that the risks of higher unemployment and higher inflation have risen since March. Meanwhile, investors still anticipate three to four 0.25% rate cuts this year, although the Fed has held off cutting so far this year due to resilient economic data, the potential impact of tariffs and lingering above-target inflation.

Consensus economist and Fed projections have downgraded the 2025 economic growth outlook since the announcement of planned tariffs from the Trump administration while increasing inflation expectations. However, Chairman Jerome Powell noted during the press conference that the Fed remains in a good position to exercise patience before changing policy rates, citing a still-solid U.S. economy.

Aggressive policy tightening in the form of rate hikes between early 2022 to mid-2023 helped drive the Core Personal Consumption Expenditures Price Index (Core PCE), the Fed's preferred inflation gauge, from a peak above 5.5% year-over-year in 2022 to 2.6% in March.

The Fed slowed the reduction of its $6.4 trillion bond holdings last month. The bond holdings peaked at $8.5 trillion in 2022 before the Fed allowed bonds to mature without replacement up to $60 billion per month, then shrinking the pace of runoff in April to $40 billion per month. Slower or no balance sheet runoff improves market liquidity, which refers to the amount of money readily available to buy goods, services and financial assets in an economy. Strong liquidity can also provide cushion against unforeseen financial market shocks, and liquidity measures remain constructive for now.

Market pricing of the expected path of the federal funds rate

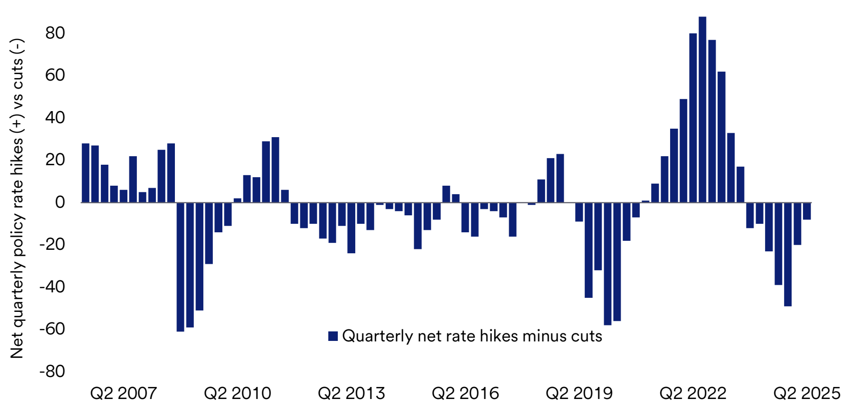


Source: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg; 3/19/2025-5/7/2025.

Domestic stock prices rose slightly Wednesday, with most gains coming before the Fed's communication began. Large-company stocks, represented by the S&P 500, rose 0.43% while small-company stocks rose 0.25%. Treasury bond yields fell for longer maturities; 10-year Treasury bond yields dropped 0.03% to 4.28%, while two-year Treasury yields were unchanged at 3.78%.

Monetary policy, defined as central bank target interest rates, remains restrictive in most geographies around the globe. However, policy has been easing overall, with central bank rate cuts exceeding hikes starting in the fourth quarter of 2023 and continuing through the current quarter. Several other major central banks in addition to the Fed have already or are expected to cut rates this year, including the Bank of England, European Central Bank, Bank of Canada and the Reserve Bank of Australia.

Global net central bank rate hikes (net hikes minus cuts), quarterly



Source: U.S. Bank Asset Management Group Research, FactSet; 4/1/2006-5/7/2025.

We retain a balanced outlook for diversified portfolios, acknowledging the contrast between solid recent economic data versus potential negative impacts from tariffs. Trailing economic growth metrics are relatively benign, evidenced by strong first quarter corporate earnings and solid aggregate consumer activity based on high frequency indicators such as consumer spending, credit and debit card swipe data, restaurant bookings and TSA security checkpoint activity at airports. The volume of shipping containers departing China for the U.S. has declined and consumer and business surveys are weaker, none of which have manifested in broader economic readings yet. We will keep you informed of our views as new data becomes available and as we update our assessment of market conditions.

As always, we value your trust and are here to help in any way we can. Please do not hesitate to let us know if we can help address your unique financial situation or be of assistance.