Global Matters Weekly

20 January 2025

Fed up or ready to cut?

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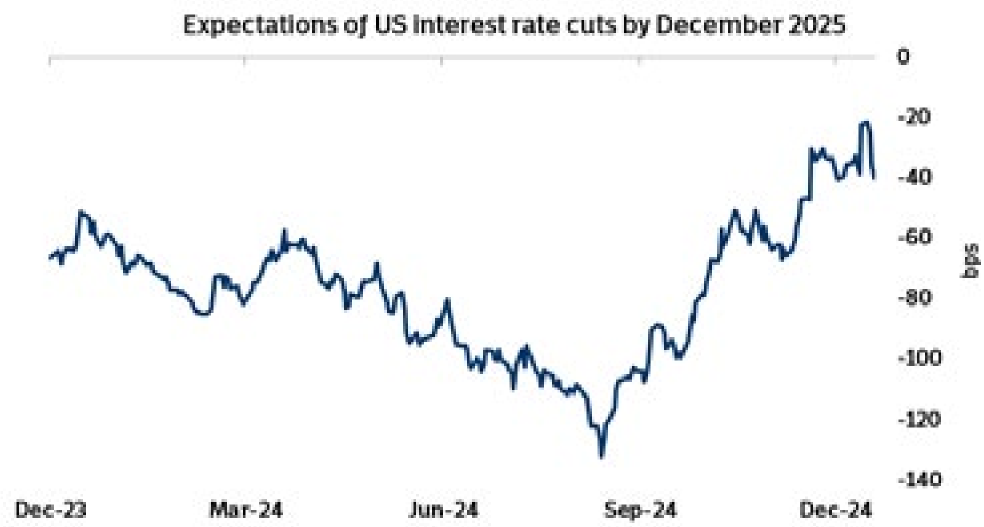
Chart of the Week



Sources: Momentum Global Investment Management, Bloomberg Finance L.P. as at 16 January 2025

What this chart shows

This week's chart illustrates the market's expectations for US interest rate cuts leading up to the December 2025 Federal Open Market Committee meeting. In the lead up to the US election, rate cut expectations had already tempered as investors began pricing in the likelihood of Trump's pro-growth and inflationary policies. Following his victory, expectations tempered further due to his policy agenda, including fiscal expansion and tariffs. However, last week's US inflation print shifted sentiment again. The December CPI report showed inflation rising to 2.9% year-on-year, above the prior month's reading of 2.7%, but the market latched onto signs of softer core inflation which moved down slightly to 3.2% after being largely flat since June. As a result, investors are now pricing in around 40bps of cuts by the end of 2025 across the eight meetings, whereas prior to the reading and after a strong jobs report, they were less optimistic and only pricing in 20bps of cuts.

Why this is important

The relationship between Trump's policies and inflation creates a challenge for the Fed. While tax cuts and looser regulation are likely to boost growth, these effects may be partially offset by inflationary pressures from new tariffs and restrictive immigration policies. Historically, these types of policies would force central banks to maintain or tighten monetary policy to contain inflation. Market expectations for lower rates in the US shifted substantially since August but now investors are betting that cooling growth in other parts of the economy might prompt the Fed to ease policy. This uncertainty leaves the Fed in a difficult position: will they prioritise containing inflation, or will they pivot to support growth if economic data softens? Recent CPI trends, particularly in core inflation, suggest a gradual disinflationary trend, but risks remain. If upcoming inflation readings, such as core Personal Consumption Expenditures, exceed expectations in the first half of the year, the Fed may need to rethink its stance—and even entertain the conversation of additional rate hikes.

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