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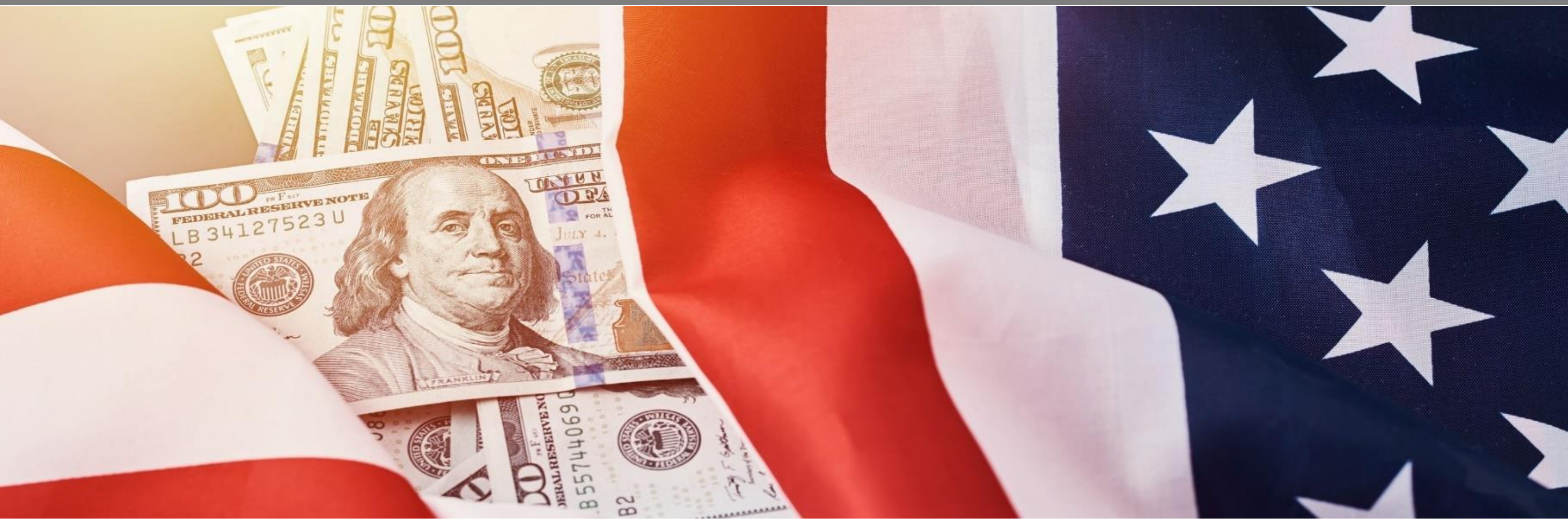
Economic Research Department

8 May 2025

Economic QuickView



FOMC Meeting: Fed Chairman Powell reiterates wait and see approach

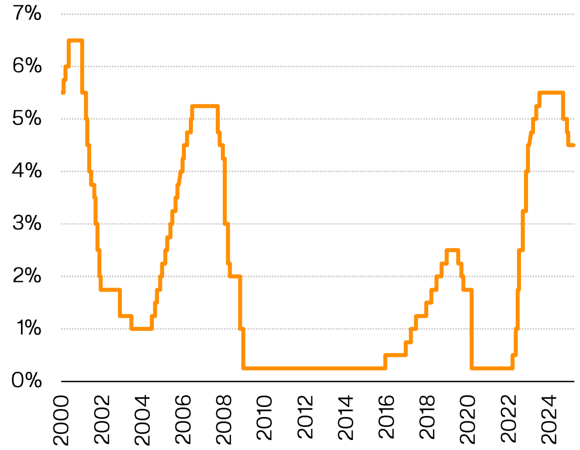
- The FOMC voted unanimously to hold the federal funds rate at 4.25-4.50% in May.
- Risks of both higher unemployment and higher inflation have risen, and the current policy is in good position to wait for more clarity.
- The Fed is expected to start cutting rates again in 2H 2025, as the negative impacts from tariffs are likely to surface gradually ahead.

The Fed held rates unchanged in May, as anticipated. During its May meeting, the Federal Open Market Committee (FOMC) voted unanimously to hold the federal funds rate unchanged at 4.25-4.50%, and to reduce its holdings of securities continuously. The post-meeting statement featured a few key changes that hint at the FOMC's view for the economy. First, the uncertainties about the economic outlook have increased further, and the Committee judges that the risks of higher unemployment and higher inflation have risen. Second, the FOMC still believes the economic activity has continued to expand at a solid pace, though swings in net exports have affected the data. The changes imply that though the uncertainties have heightened, there is no imminent deterioration in the hard data, and the FOMC can wait for more clarity.

Fed Chairman Powell indicated that policy is in a good place to wait for more clarity. In the post-meeting press conference, Chairman Powell stated that the tariff increases announced so far have been significantly larger than anticipated. If the tariffs are sustained, they are likely to generate a rise in inflation, a slowdown in economic growth, and an increase in unemployment. However, the effects on inflation will depend on the size of the tariff effects, how long it takes to pass through, and whether the long-term inflation expectations are well-anchored. Given there is no imminent deterioration in the hard data, with the labour market remaining resilient, and the current policy stance moderately restrictive, the FOMC can be patient in seeing how trade policy is affecting the economy before changing monetary policy. Notably, Chairman Powell referenced "waiting" over 20 times during the press conference.

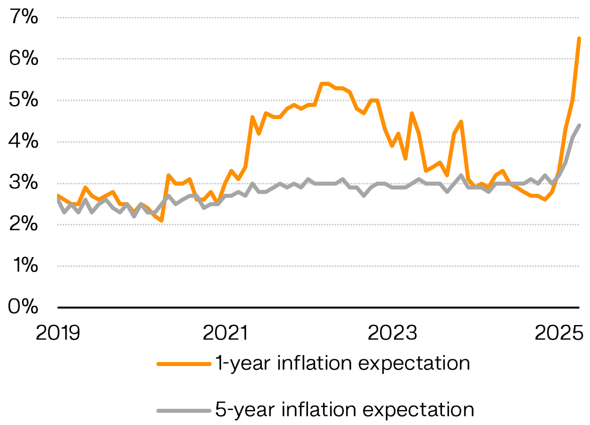
Chairman Powell offers no clue about which of the two risks to the mandate will materialise first. As the Fed's dual mandates, i.e. maximum sustainable employment and price stability, could both be challenged by the policy changes under the new Administration, Chairman Powell said in the press conference that it was too soon to say which way that would "shake out." While he didn't offer a firm forecast, Chairman Powell did repeat a remark that without price stability, we cannot achieve the long periods of labour market strength, apparently making price stability the first among equal mandates. Therefore, the FOMC would like to adopt a wait and see approach for more clarity about the fragility of either inflation expectations or labour market performance.

US Fed Funds Rate (Upper)



Source: Bloomberg

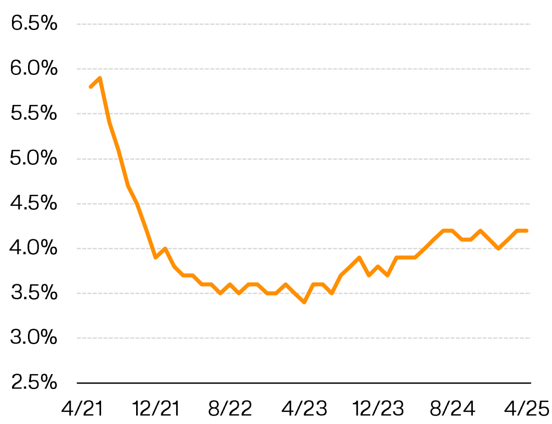
University of Michigan Consumer Inflation Expectations



Source: Bloomberg

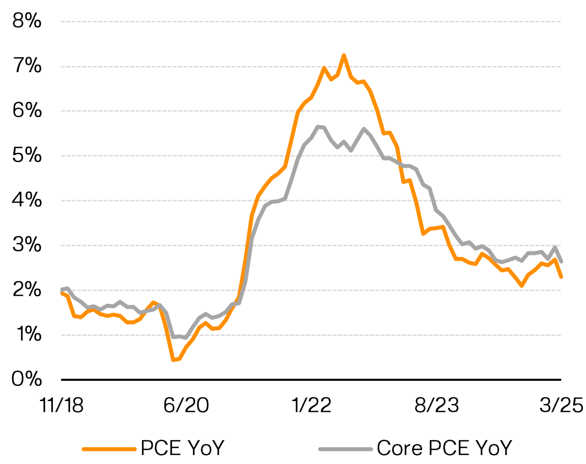
Rate cuts remain a base case for 2025. Despite the Fed's cautious stance, trade-related uncertainties, particularly the high tariff rate and prolonged negotiation with China, are likely to negatively impact the US economy and employment market going forward, which will open the door for rate cuts in 2H 2025. On balance, we expect the Fed to start cutting rates in September, with the possibility of a 25 basis points cut every quarter thereafter, with Hong Kong prime rates to follow the path of US interest rates, but at a smaller magnitude.

Unemployment rate



Source: CEIC

US PCE Inflation



Source: Bloomberg, data as of 30/04/2025

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