Macro Note

US May 2025 FOMC: Fed "can wait" amidst tariff risks

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- The Fed in its 6/7 May 2025 Federal Open Market Committee (FOMC) meeting, unanimously decided to maintain the Fed Funds Target Rate (FFTR) at a range of 4.25%-4.50%, for the 3rd straight meeting and in line with market and our expectations. The Fed Board of Governors of the Federal Reserve System also voted unanimously to keep the interest rate paid on reserves (IOER) balances unchanged at 4.40%, maintain the pace of the monthly reduction of US Treasuries at US$5 bn and the reduction of mortgage-back securities (MBS) at US$35bn, as well as approve the establishment of the primary credit rate at the existing level of 4.5%.

- The key change in the text of the May monetary policy statement (MPS) was that the Fed now warned that "*uncertainty about the economic outlook has increased **further***" (from "uncertainty around the economic outlook has increased" in the Mar statement) while adding a new warning that the committee "*judges that the risks of higher unemployment and higher inflation have risen*". FOMC Chair Powell assured markets the Fed officials are not in a hurry to adjust interest rates citing "*costs of waiting are fairly low*" while warning that the "*tariffs so far significantly bigger than expected and "great deal of uncertainty about tariffs*", and if the large increases in tariffs as announced are sustained, it could lead to higher inflation and lower employment.

- **FOMC Outlook – Pushing back the rate cut timeline while keeping faith with the three 25-bps rates cut view for 2025.** Given the Fed is advocating for patience even as it has upped its warnings about the risks of higher inflation and unemployment due to the tariffs, we continue to hold our view of three 25-bps cuts in 2025, though we have decided to push back the expected timeline to Sep, Oct and Dec FOMC, bringing the Fed Funds Target rate (FFTR) to 3.75% (upper bound of FFTR) by end-2025 (previous timeline was one cut in each quarter, 2Q (Jun), 3Q, and 4Q). We are also keeping our view for the two rate cuts for 2026, implying a lower terminal FFTR of 3.25% in 2026.

May 2025 FOMC: Another well-anticipated pause as the Fed can afford to wait

The US Federal Reserve (Fed), in its 6/7 May 2025 Federal Open Market Committee (FOMC) meeting, unanimously decided to maintain the Fed Funds Target Rate (FFTR) at a range of 4.25%-4.50%, in line with market and our expectation. This was the third consecutive policy pause after the 100-bps cut in the last three meetings of 2024. Separately, the Board of Governors of the Federal Reserve System also voted unanimously to keep the interest rate paid on reserves (IOER) balances unchanged at 4.40%, maintain the pace of the monthly reduction of US Treasuries at US$5 bn and the reduction of mortgage-back securities (MBS) at US$35bn, as well as approve the establishment of the primary credit rate at the existing level of 4.5%, as stipulated in its May 2025 Implementation Note.

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For the May FOMC, Minneapolis Fed President Kashkari voted as an alternate for Kansas City Fed President Schmid who was absent from the May FOMC.

The key changes to the text of the May monetary policy statement (MPS) were:

1) The Fed now warned that "*uncertainty about the economic outlook has increased* ***further***" (from "uncertainty around the economic outlook has increased" in the Mar statement) while adding a new warning that the committee "*judges that the risks of higher unemployment and higher inflation have risen*".
2) Although the Fed added that "*swings in net exports have affected the data*", it still maintained the view that "*recent indicators suggest that economic activity has continued to expand at a solid pace*." (unchanged from Mar FOMC) There was no change to the Fed's assessment of the US labor market and the US Inflation situation ("*The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated*" which is a carbon copy of the Mar 2025 FOMC).

Powell's Presser: Advocating patience as costs of waiting fairly low

In his press conference, FOMC Chair Powell said the Fed officials are not in a hurry to adjust interest rates citing "*costs of waiting are fairly low*" while warning that the "*tariffs so far significantly bigger than expected and "great deal of uncertainty about tariffs*", and if the large increases in tariffs as announced are sustained, it could lead to higher inflation and lower employment. Powell also pointed out that the US is now in a new phase where the administration is beginning trade talks, which has potential to change picture materially or not. While Powell noted that there are cases in which rate cuts would be appropriate this year, he could not confidently say "I know the appropriate rate path" as uncertainty is extremely elevated. He also declined to make a projection about the number cuts this year, deferring that decision to the Jun FOMC.

The main message from Powell seemed to be "*We don't feel like we need to be in a hurry. We feel like it's appropriate to be patient*.".

Our FOMC Outlook – Pushing back the rate cut timeline while keeping faith with the three 25-bps rates cut view for 2025

The latest FOMC decision looked to have affirmed the view that the Fed will continue with its "wait-and-see" approach to gain more clarity on trade and other policy measures but now with greater upside risks associated with inflation and unemployment, given that the tariffs announced were significantly bigger than expected.

Going forward, we keep the view that the impact of the US trade policies will be significantly weaker growth outlook for the US and Asia (but not amounting to outright recession in US although that probability is higher at 40% now), accompanied by higher US inflation outturns, which we assume to be a one-time spike in prices before coming off from the headline inflation sometime next year. Given the Fed is advocating for patience even as it has upped its warnings about the risks of higher inflation and unemployment due to the tariffs, we continue to hold our view of three 25-bps cuts in 2025, though we have decided to push back the expected timeline to Sep, Oct and Dec FOMC, bringing the Fed Funds Target rate (FFTR) to 3.75% (upper bound of FFTR) by end-2025 (previous timeline was one cut in each quarter, 2Q (Jun), 3Q, and 4Q). We are also keeping our view of the two rate cuts for 2026, implying a lower terminal FFTR of 3.25% in 2026.

According to Bloomberg's WIRP (as of 8 May) with reference to Fed Funds Futures, markets are pricing a moderately low 20.1% probability of a rate cut in the 17/18 Jun 2025 FOMC. The probability rose significantly to 82.1% for a rate cut in Sep FOMC, which is in line with our base case projection. And according to the CME FedWatch Tool, markets are pricing in a similar 20% probability for a 25-bps rate cut in Jun and a higher 94.8% for a cut by the Sep (as of 8 May).

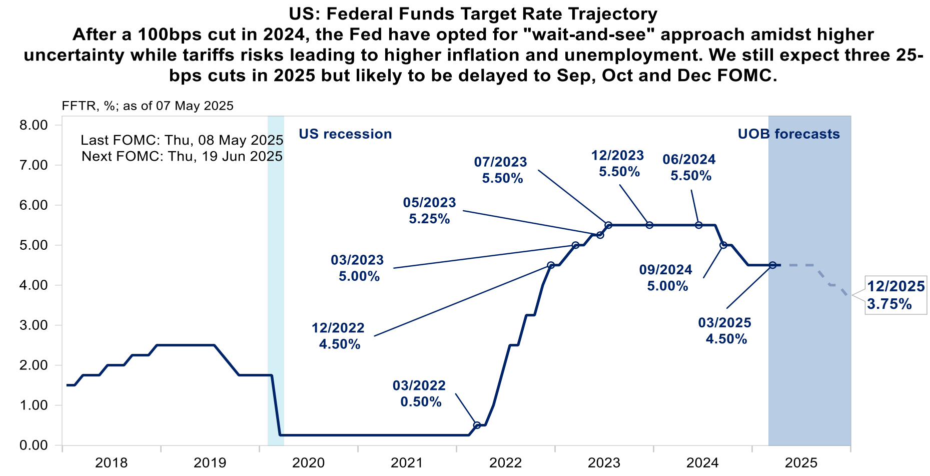
The next FOMC meeting will be on 17/18 Jun 2025 (Decision on 19 Jun 2am SGT), accompanied by Powell's press conference and an updated Summary of Economic Projections (SEP).

Please use the following links to access the official Fed documents:

i. The 6/7 May 2025 FOMC statement
ii. The Mar 2025 FOMC Implementation Note (interest rate paid on reserves, IOER, unchanged at 4.40%, effective from 9 May 2025)
iii. The FOMC calendar for 2025 and 2026.

Chart 1: UOB's Projected US Federal Funds Target Rate Trajectory (As Of 8 May 2025)

Source: Macrobond, UOB Global Economics & Markets Research



Our Forecast

%	As of 8 May	2Q25	3Q25	4Q25	1Q26
US Fed Funds Target - Upper Bound	4.50	4.50	4.25	3.75	3.75

Source: Global Economics & Markets Research (as of 8 May 2025),

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