With inflation cooling and growth steady, CIO sees an attractive environment for risk assets, particularly as the Fed moves toward further policy accommodation. (UBS)

CIO believes that the Fed will resume its easing cycle later in the year

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The Federal Reserve kept rates unchanged for the first time since beginning its easing cycle, following 100 basis points of cuts over the past three policy meetings. The decision was widely expected after the Fed struck a more hawkish tone in December.

Chair Jerome Powell signaled that policymakers see no urgency to ease further, given the resilience of the economy. Notably, the Fed adjusted its messaging on inflation, dropping the language that price pressures "have made progress" and instead stating that inflation "remains elevated."

Moreover, the Fed hinted at a stronger outlook for the labor market, saying that conditions "remain solid" and that unemployment had "stabilized at a low level." That contrasted to its statement in December that the jobs market had "eased" and that unemployment had "moved up but remains low."

But we believe that the Fed will resume its easing cycle later in the year.

Inflation looks set to ease closer toward the Fed's 2% target by the middle of the year. Recent monthly CPI data was reassuring at 0.2% month over month. Shelter inflation has remained strong but should come down as the lagged effect of slower rental increases feeds through. Powell said that he expected shelter to contribute to disinflation in the coming months—although policymakers would need to see this coming through into the data. Powell added that inflation did not need to fall all the way back to the Fed's 2% target before rates are cut further.

Monetary policy remains restrictive, giving scope to cut further, especially as growth moderates. It is true that growth has been stronger than expected for some time. The Atlanta Fed's GDPNow has growth on track for 2.3% in the fourth quarter—solid, but not a level that suggests overheating. Jerome Powell said that policy was "meaningfully less restrictive" than at the peak in rates, and so officials would be looking for further progress on inflation and cooling labor market conditions before cutting again. But Powell did say that monetary policy was still "meaningfully" above the neutral rate. This should give scope for further cuts.

While looser fiscal policy, higher trade tariffs, and restrictive immigration policies under President Trump could put upward pressure on inflation and hold back rate cuts, this is far from clear. This point was also stressed by Powell. At the press conference, the Fed chair said that the outlook for policy in all these dimensions remained "uncertain," and the Fed would not prejudge how it could evolve. "We are going to wait and see," he said, adding that "the range of possibilities is very wide" on tariffs. His comments came after Bank of Canada Governor Tiff Macklem warned that "a long-lasting and broad-based trade conflict would badly hurt economic activity in Canada." That came as the Bank of Canada cut rates 25bps.

Our base case is that while the Trump administration will be aggressive in its use of tariffs, it will seek to avoid actions that would risk rekindling inflation.

So, with inflation cooling and growth steady, we see an attractive environment for risk assets, particularly as the Fed moves toward further policy accommodation. We still expect the equity market to rally: Our year-end forecast for the S&P 500 is 6,600 in our base case. And declining cash rates underline the importance of putting capital to work. We also view the outlook for high grade and investment grade bonds as positive and expect the 10-year Treasury yield to fall to 4.0% by the end of 2025.

Original report: **Fed puts rate-cutting cycle on pause, 30 January 2025.**

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