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

Fed pause doesn't mean the end of the cycle

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The Federal Reserve has paused its rate-cutting cycle after reducing rates by 100 basis points over the past three meetings. The decision was widely anticipated following a more hawkish tone from the central bank's December gathering.

Once again Fed Chair Jerome Powell indicated no immediate need for further easing due to the economy's resilience. Notably, the Fed adjusted its messaging on inflation, dropping the language that price pressures "have made progress" and instead stating that inflation "remains elevated."

But despite the pause and more hawkish comments, 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. However, Powell said that he expected shelter to contribute to disinflation in coming months as the lagged effect of slower rental increases feeds into the data. He added that inflation did not need to fall all the way back to the Fed's 2% target before rates are cut further.

The Fed chair also told reporters that monetary policy was still "meaningfully" above the neutral rate, so is still constraining growth even after the easing since September. That suggests the cutting cycle is not yet over.

While looser fiscal policy, higher trade tariffs, and restrictive immigration policies under 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.

Takeaway: 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.

Original report: **Navigating global trade tensions, 3 February 2025.**