Fed Watch: Will It Be Déjà vu All Over Again?

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Key Takeaways

- With the Fed resuming rate cuts at its September FOMC meeting, investors are now watching closely to see if 2025 will mirror last year's end-of-year easing cycle.
- While recent inflation data is creeping higher, the Fed remains primarily focused on a softening labor market.
- If neutral policy is around 3.5%, as some suggest, investors should prepare for up to two more rate cuts this year, possibly front-loaded depending on job market trends.

As was widely expected, the Federal Open Market Committee (FOMC) implemented a 25-basis-point (bp) rate cut at the September FOMC meeting, bringing the new Fed Funds trading range down to 4%–4.25%. With the resumption of rate cuts now officially "in the books," the more pertinent question is what will the Fed have in store for the markets for the remainder of this year and 2026? Remember, it was exactly a year ago that Powell & Co. embarked on this rate cut cycle and followed their first rate cut in September 2024 with two more easing moves to finish off the year. Will history repeat itself here in 2025? That's what inquiring minds want to know.

First up, let's look at the key factor in the Fed's current decision-making process, namely the labor market backdrop. Although the Fed does focus on its dual mandate of employment and inflation, there is no question that the primary focus right now is on the employment side of the equation, especially given the recent stalling out in new job creation.

However, at some point, if upcoming jobs data does not deteriorate any further, the policy maker could shift its attention back to an equal weighting for inflation. It is interesting that recent commentary on inflation measures, such as CPI, has been centered on the data coming in "as expected." But the underlying data has shown that the spring bout of disinflation is now over, and price pressures are now grinding higher. In fact, core CPI is running at an annual rate of +3.1%, the highest reading since February, and moving further away from the Fed's target of +2.0%. For the record, the Fed's preferred inflation measure, Core PCE, is also moving further away from target, at +2.9%.

So, back to where the Fed may be headed in the months ahead. There's no doubt that the tilt will be for further rate cuts, as the voting members have consistently stated that, prior to this latest easing move, monetary policy had been modestly/mildly restrictive. Based upon economic data at this point, there

doesn’t seem to be a need to go into an “accommodative phase” for policy just yet, but perhaps just get back to “neutral.”

Now, what is a neutral Fed Funds Rate? That is the key question going forward. If you believe it lies in the area of 3.50%, then investors could expect to see two additional quarter-point rate cuts forthcoming. Two more rate cuts could come at each of the remaining FOMC meetings this year, or perhaps Powell & Co. may want to take a more deliberate approach and utilize an “every other” meeting approach to wait out the labor market/inflation data.

The Bottom Line

With Fed policy remaining highly data-dependent at this stage of the game, getting policy to neutral is a good starting point. If the upcoming employment data doesn’t improve, or gets worse, in the months ahead, then the voting members will more than likely front-load their rate cuts and get them in before year-end…then on to 2026.