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GLOBAL ECONOMICS

SCOTIA FLASH

June 18, 2025

FOMC Signals It's Taking the Summer Off

- **The FOMC held the policy rate and balance sheet measures as expected**
- **The dot plot removed one cut from the projection period…**
- **…but stood by 50bps this year…**
- **…despite raising inflation projections more than unemployment forecasts…**
- **…which might explain why divisions run deep on policy guidance**
- **Powell's guidance basically rules out July at a minimum**
- **If the Fed delivers its 2025 cuts, markets won't believe its 2026 guidance**
- **Markets shook it all off**

I can't help but feel that this meeting and all the effort that went into the communications was a total waste of time. Markets tended to agree as there was very little change across key benchmarks. The overall message remains one of patiently spending the summer months evaluating incoming data and developments before deciding upon an appropriate course of action.

KEY PUZZLES

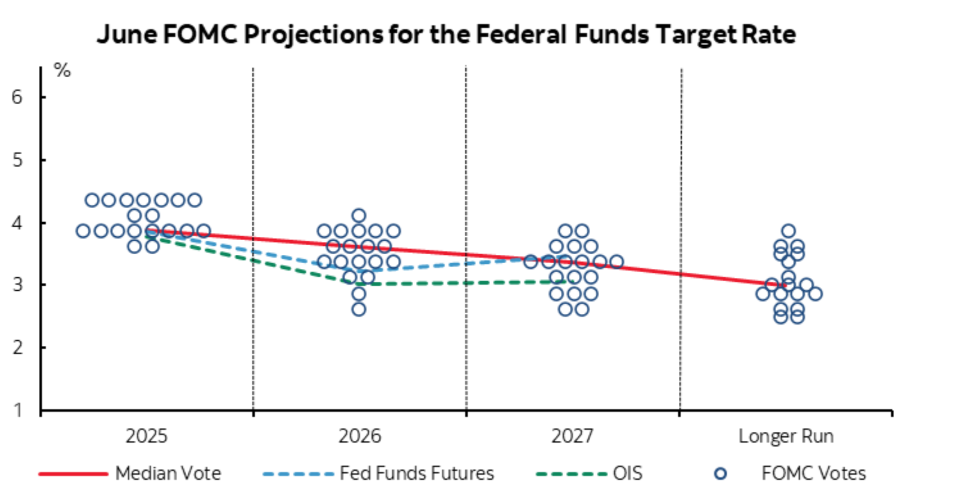
Before turning to the details, there were several incongruencies or puzzles that presented themselves in this set of communications.

One is that the Committee revised up forecasts for inflation by more than for unemployment in 2025 while still sticking with two cuts this year as the median projection. Signalling they are straying further from price stability goals than full employment is tough to square against standing by the same amount of cuts.

Second is that the Committee is extremely divided including on this year's policy rate guidance which matters more than the median projection and leaves markets guessing at any viable policy path from here. I'll come back to that in the projections below.

Third is whether the Committee is naïve in its implied belief that should it cut twice this year as per the median dot, then markets would believe its guidance to only cut once in 2026. Assuming July is out—which I'll return to—then two cuts in the remaining three meetings this year would probably be perceived as a violation of the patient and gradual mantra. Markets would likely bring forward a whole series of cuts and ease financial conditions more than the Committee's guidance implies they may be prepared to accept.

Chart 1



Note: OIS & Fed Fund Futures as of Jun. 18, 2025.
Sources: Scotiabank Economics, US Federal Reserve.

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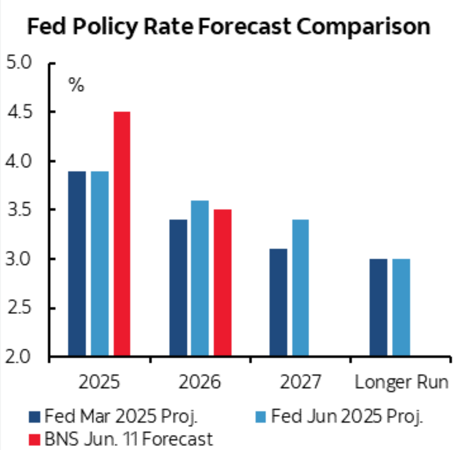
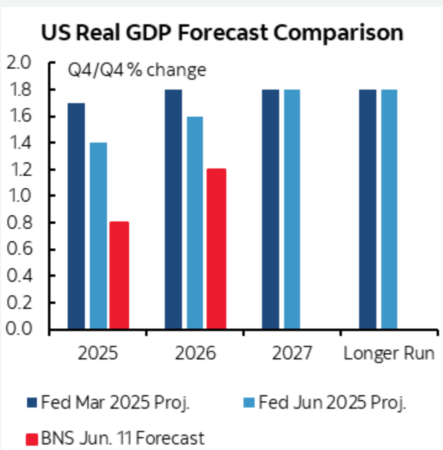
Chart 2



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 18, 2025).

Chart 3



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 18, 2025).

POLICY RATE PROJECTIONS

The median Committee forecast still expects the same 50bps of cuts this year but took one out of 2026 when only one rate cut is signalled and carried that through to 2027 when only one more cut is indicated.

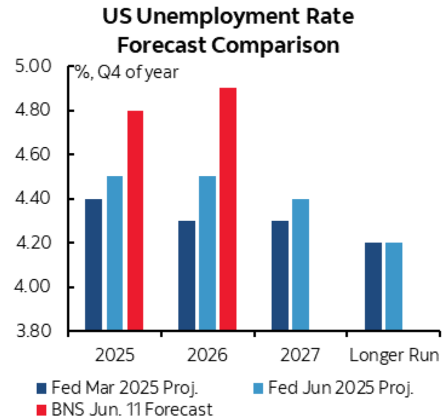
In total, the 50bps this year and 25bps in each of the next two would mean 100bps of cumulative easing that two-and-a-half years from now would remain at a still restrictive level of 3½%. That's so far out that few pay attention to it, but the point is that on net the Committee is signalling slightly less comfort to ease policy on net over the full projection period.

The longer-run neutral rate guidance was unchanged at 3%.

But the medians mask large divisions across the Committee. For example, the 2025 dot plot shows 7 who want no cuts at all this year, two who only want one 25bps cut, 8 would want 50bps of cuts, and two who want 75bps of cuts.

The divisions are larger for next year and thereafter as shown in chart 1. Chart 2 compares the FOMC median projections to our forecasts.

Chart 4



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 18, 2025).

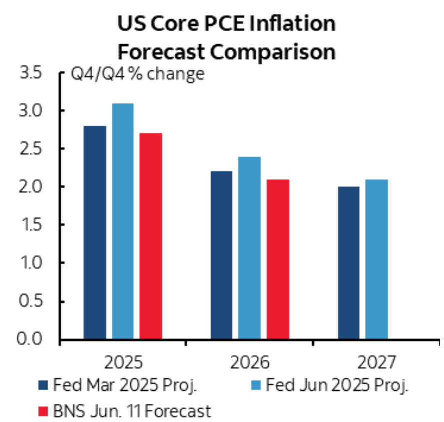
MACROECONOMIC PROJECTIONS

GDP growth projections were revised down for this year (1.4% from 1.7%) and next year (1.6% from 1.8%) while 2027 and the longer run figures were left unchanged at 1.8%. The Fed is more upbeat than our projections (chart 3).

The Committee's median forecast for the unemployment rate was revised up a tick to 4.5% this year and two-ticks to 4.5% next year while 2027 was raised to 4.4% from 4.3%. The longer-run natural rate was left unchanged at 4.2%. The Committee's median projection is more optimistic than we are (chart 4).

The Committee's projection for core inflation was revised up throughout the 2025–27 projection period. 2025 is forecast at 3.1% y/y from 2.8% previously, 2026 was revised up two-tenths to 2.4% and 2027 was revised up a tick to 2.1%. Chart 5.

Chart 5



Sources: Scotiabank Economics, Federal Reserve Summary of Economic Proj. (Jun. 18, 2025).

I'll repeat that it's somewhat odd that the patience message emphasizes waiting until they have clarity on which part of the mandate deteriorates the most before deciding upon an appropriate policy rate path, while nevertheless sticking to two cuts this year after revising up inflation more than the unemployment rate. That should be consistent with predicting less easing.

This last point may be why the 2025 dots went from just four committee participants expecting no cuts this year in the March plot, to seven now. But it doesn't explain why the median did not pivot toward fewer cuts.

STATEMENT CHANGES

The appendix includes a comparison of this statement with the prior one on May 7th. There were only a few changes.

The key one was upgrading the assessment of uncertainty. They've gone from saying it increased further to saying it has diminished. That's consistent with surveys and trade policy uncertainty metrics. That doesn't mean it's correct. Tariffs remain high and Trump's nearer-term warnings on tariffs being imposed on countries that don't strike deals and the China deadlines are looming. Developments in Iran were dismissed as usually only causing brief flares in oil prices; I hope he's right given risk of contagion effects. And the US fiscal package appears to be stalled in the Senate.

They also struck out reference to how "risks of higher unemployment and higher inflation have risen" which may or may not be premature.

There were no dissenters or substitutes among the voters.

PRESS CONFERENCE

The broad message of the press conference was summarized by Powell's guidance that the FOMC thinks it is well positioned to wait to learn more before considering adjusting the policy stance.

Powell may have implicitly ruled out a move in July by stating "We can wait a couple of months or however long it takes to evaluate the effects" of tariffs and other developments on the dual mandate of price stability and full employment.

I'm glad someone challenged Powell on why has uncertainty 'diminished'. Iran is potentially flaring. The fiscal package is bogged down in the Senate. The tariffs have pulled off the peaks but remain high with no material deals and deadlines looming as Trump's two-week warning soon expires.

It's also good that at least someone asked the Chair about data quality as Powell seemed to lean heavily on soft recent inflation data without providing a hint—until asked—that the data may be garbage which is my belief. Seasonal adjustment factors are artificially low and budget cuts have driven the guesstimate share of the CPI basket to a record high 30% for the last two months.

No ones asked Powell about next week's meeting on potential changes to the Supplementary Leverage Ratio.

What follows is a loose attempt at summarizing key Qs and As in the presser with any errors or omissions to be blamed on my typing abilities while listening to fast talkers!

Q1. To what extent has limited effect of tariffs to date changed your view on the fallout and timing?

A1. We've had three months of soft inflation data significantly due to services. Goods inflation has moved up a bit and we do expect to see more of that over the course of the summer. It takes some time for tariffs to work their way through to the end consumer. We're beginning to see some effects and we do expect to see more over the summer. In addition, we look at surveys of businesses and many companies do expect to put some or all of the effect of tariffs to the next person in the chain and ultimately to the consumer. The amounts and duration are all highly uncertain. That is why we are being patient.

Q2. Is the reason you show cuts because you think inflation will be well contained or because growth will deteriorate?

A2. The forecasts expect inflation to come up and then back down. One of our jobs is to make a one-time increase in inflation doesn't become a problem. That depends on keeping inflation expectations anchored.

Q3. You've taken a quarter point per year out of your projected path. Is that a result of the belief that tariffs will drive more persistent inflation or a higher neutral rate?

A3. I would focus more on the nearer term. As you get out into the later years it's harder to determine. We're adapting in real time. This is an accumulation of individual assessments.

Q4. Missiles are being exchanged, tariffs are still out there. How can you say risks have diminished?

A4. Many surveys say that, The teal book also says that which you'll see in five years from now. Tariff uncertainty peaked in April. It's diminished but still elevated.

Q5. Do you see any reason the economy is weakening as a reason to cut rates going forward?

A5. 4.2% unemployment and the economy is growing at a rate that appears to be 1.5–2% maybe a little better and sentiment is off its low levels but still depressed. The housing market has its own unique challenges. The job market, labour force participation etc is holding firm.

Q6. There is the alternate scenario that tariffs drive demand destruction. What are the odds and how many months of cool inflation would be required to assess?

A6. This is part of what we discussed. No one holds these rate paths with a great deal of conviction. Everyone agrees they will be very data dependent. [ed. yes tariffs are demand destruction, but issue is timing. First round is the inflation debate before the demand destruction if sustained]

Q7. How many months does it take for the data to give you confidence to reduce rates?

A7. We know that the outcome could come quickly or not. As long as we see current conditions we feel the appropriate thing to do is to stand pat in a good place. We think we will learn much more over the summer.

Q8. Can you explain more about the divergence in the 2025 rate projections? Is it a matter of people having a different outlook of a different reaction function or a different commitment to defending against another inflation mistake?

A8. We did have strong support for this decision and agreement we are in a good place. The first point is that there is diversity across the underlying projections for inflation, growth etc. As we get more data, those differences should diminish. Secondly, people can look at the same data and evaluate the risks differently. No ones holds these rate paths with a whole lot of conviction.

Q9. Why wouldn't it be better to have rates at a more neutral setting going into this period of high uncertainty?

A9. If you just looked backward that could be true. But we have to be forward-looking and we expect inflation to pick up over coming months. Because the economy is still solid we can take our time to evaluate this. We can wait a couple of months or however long it takes to evaluate the effects.

Q10. Would Trump's criticisms of the Fed potentially impact the economy, markets, and the Committee?

A10. Everyone on the Committee wants the same things. The economy has been resilient. We think we're in a good place to respond to significant developments.

Q11. Would you stay on as Governor if you are not appointed to another term as Chair?

A11. I'm not thinking about that.

Q12. With workplace raids picking up what could be the effect?

A12. We don't comment on immigration policy. But the unemployment rate has been solid, well within the range of maximum employment, and labour supply has been diminishing. Supply and demand have kept the UR in a reasonably stable place.

Q13. What potential changes to the SEP are part of the framework review?

A13. We said we'll finish the framework part by the end of the summer [ed. Jackson Hole?]. The second part is the communications tools which we said we'll address in the fall. The SEP is part of it and so are many other ideas. We're going to look at those with staff briefings and thought in the fall. I would only implement things that have broad support.

Q14. What made you feel comfortable cutting in December when inflation was higher than now when inflation is lower and you didn't cut?

A14. We forecast lower inflation then. We've had tariffs since. Our inflation forecasts are six-tenths higher for 2025 now than back in December due to tariffs.

Q15. Should Americans expect economic pain in the second half of the year?

A15. I'm not saying that at all. I'm waiting for evidence on inflation and tariff effects. Everyone is forecasting a meaningful rise in inflation over coming months.

Q17. How much of a concern do you have that gauges to watch the economy are reliable now given cutbacks?

A17. I'm not concerned we cannot do our jobs. The point is that we are starting to see cutbacks in data collection and that's going to leave more volatility in data. Having more data helps the Fed, Congress, the Executive branch and businesses. The US has been a leader in this area and I hate to see us cutting back on that. It's a real benefit to people in all kinds of jobs to have good data.

Q18. Will a new Fed Chair next year affect your framework review and whether it is durable?

A18. It goes back to 2012 and it's the Committee's document. It shouldn't depend on who is the particular chair.

Q19. How are you thinking about how the Iran conflict may impact the economy especially inflation? What lessons were learned in 2022 when the Ukraine war sent oil and gas prices skyrocketing?

A19. When there is turmoil in the Middle East, oil prices tend to spike but tend to come back down. They tend not to be lasting except in the 1970s. The US economy is far less dependent on foreign oil today. [ed. yes, but, still a connected global market]

Q20. What do you expect in terms of the AI impact on employment?

A20. Will AI augment or replace labour is the question. It may be doing both. This is something that has transformational potential and we're probably in the very early stages compared to two years from now. There are optimists who emphasize productivity and pessimists who emphasize job losses. We just don't know and don't have a house view on that.

Q21. Some argue that the US economy is going through a profound change like in the Bretton Woods era. Are we going through something like that now? Does it fundamentally affect how you do monetary policy?

A21. It doesn't change our objectives in the near term. All of those issues are for elected governments.

Q22. What is the view of growing slack in the job market, weaker payrolls, risks to wage growth

A22. You don't really see slack.

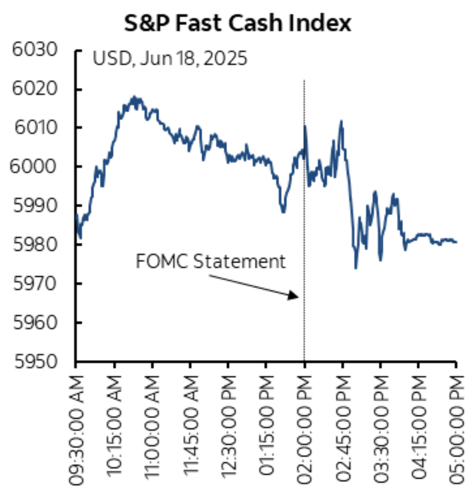
Q23. Why do you think there are no forecasts for rate hikes this year or next as inflation rises?

A23. There are a number of people who wrote down no cuts this year and some cuts next year. They are writing down their most likely paths, they are not saying there is not probability of other views. We don't rule things in or out. A hike is not the base case.

MARKET EFFECTS

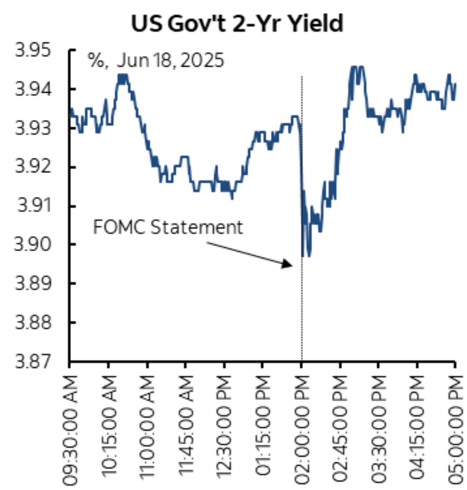
Markets didn't really care one bit about it all. The US two-year Treasury yield is basically flat to pre-2pmET announcements. The dollar is little changed. The 10s yield is only about 2bps higher. The S&P moved very slightly lower. See charts 6–9.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

Chart 7



Sources: Scotiabank Economics, Bloomberg.

Chart 8

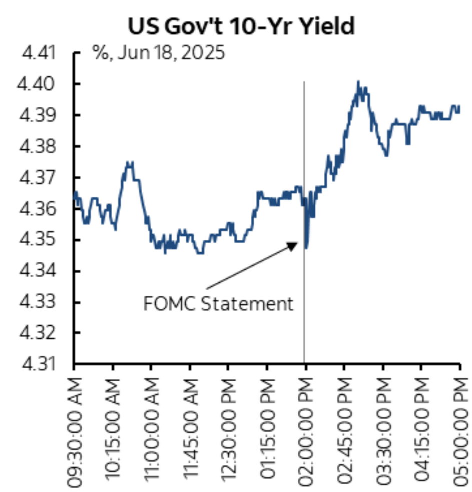


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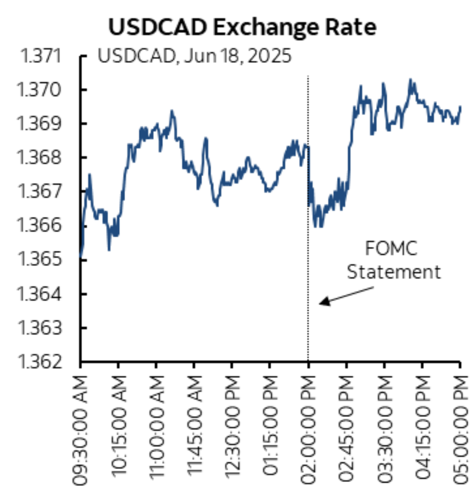
Chart 9



Sources: Scotiabank Economics, Bloomberg.

RELEASE DATE: June 18, 2025

Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace. ***The unemployment rate remains low,*** and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. ***Uncertainty about the economic outlook has diminished but remains elevated.*** The Committee is attentive to the risks to both sides of its dual mandate.

In support of its goals, the Committee decided to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. In considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook. The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations, and financial and international developments.

Voting for the monetary policy action were Jerome H. Powell, Chair; John C. Williams, Vice Chair; Michael S. Barr; Michelle W. Bowman; Susan M. Collins; Lisa D. Cook; Austan D. Goolsbee; Philip N. Jefferson; Adriana D. Kugler; Alberto G. Musalem; Jeffrey R. Schmid; and Christopher J. Waller.

RELEASE DATE: May 7, 2025

Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace. The unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid. Inflation remains somewhat elevated.

The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. ***Uncertainty about the economic outlook has increased further.*** The Committee is attentive to the risks to both sides of its dual mandate ***and judges that the risks of higher unemployment and higher inflation have risen.***

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