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Economic Research

Economic Briefing

Fed keeps rates unchanged, waits for clarity

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The Fed has left its key interest rates unchanged for the second time in a row. Although its updated projections still show two interest rate cuts in the further course of the year, more monetary policymakers than before can imagine not lowering the key rates at all or only once. The Fed emphasizes the currently unusually high degree of uncertainty. An adjustment of monetary policy requires more “clarity”.

Fed leaves key interest rate unchanged…

As expected, the Fed has not changed its interest rates, so the target range for the federal funds rate remains at 4.25% to 4.50%. The Fed had already held steady at its last meeting in January. In the statement, the Fed notes that uncertainty around the economic outlook has increased. However, the pace of economic expansion is still described as “solid” despite the concerns about a recession that have arisen in the markets.

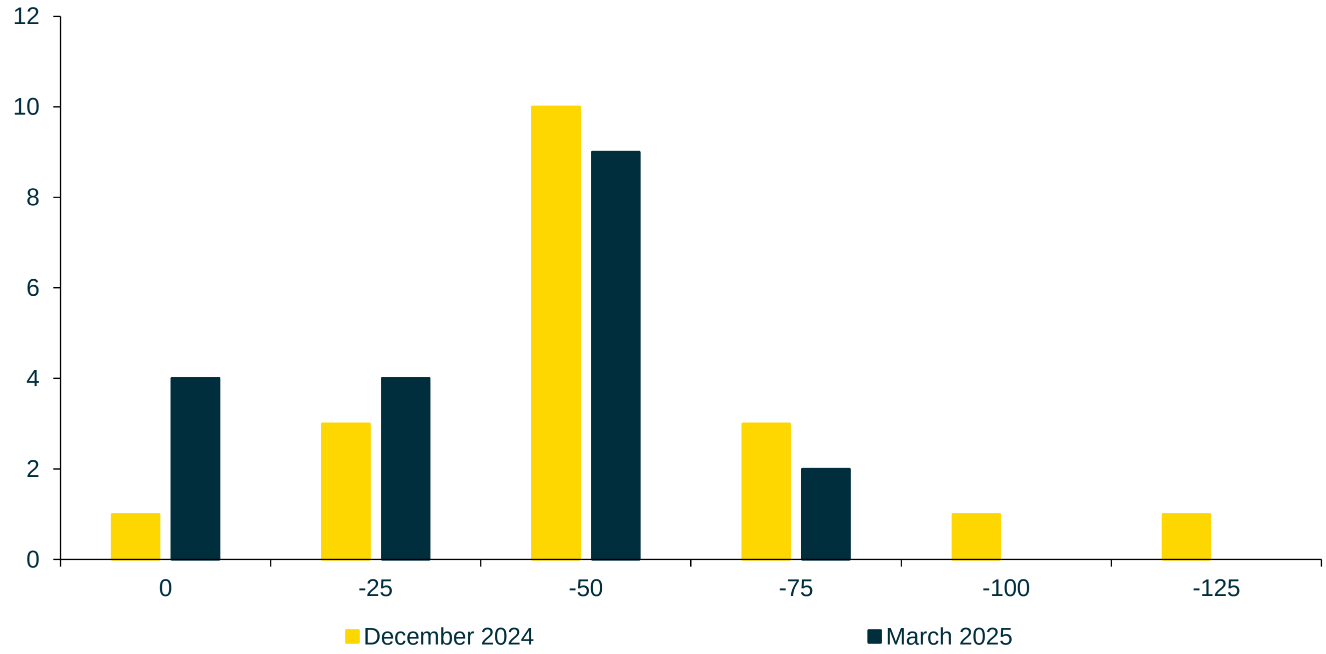
The Fed has also decided to slow the reduction of its bond portfolio (a process known as quantitative tightening, QT). The reduction of Treasury securities is now to be a maximum of $5 billion per month, down from $25 billion. This is in response to some tensions in the money market. The cap for mortgage-backed bonds remains at $35 billion per month. Since mid-2022, the Fed's bond holdings have been reduced by around $2 trillion to just under $6.5 trillion. Governor Waller voted against the slowdown in the portfolio reduction.

… updates its projections

The Fed has published the new projections of the FOMC meeting participants. They have become more pessimistic about inflation this year. Participants now expect a core inflation rate of 2.8% at the end of the year, up from 2.5% in December. This would also be a slight increase from the current level of 2.6%. However, the longer-term path to the 2% target has not changed in the Fed's opinion. At the same time, members expect less growth, especially this year (1.7% after 2.1% previously for the comparison of 2025 Q4 with 2024 Q4).

These new projections have consequences for the appropriate Fed funds rate path. At first glance, higher inflation and lower growth roughly offset each other, according to the FOMC participants. On average, the meeting participants continue to expect two interest rate cuts of 25 basis points each over the rest of the year. However, opinion has shifted noticeably towards less aggressive interest rate cuts. Now, only two members still expect interest rate cuts totaling 75 basis points or more for 2025. Before that, the figure was five (chart). At the same time, more policymakers than before can imagine cutting interest rates only slightly or not at all.

Chart 1 - Support for large rate cuts in 2025 has waned
assessments of appropriate change in federal funds rate in 2025 in basis points; number of FOMC participants making that projection



Source: Federal Reserve, Commerzbank Research

... and emphasizes unusually high level of uncertainty

Fed Chairman Powell sees the hard data as still solid overall. The weakening of “soft” data – such as consumer confidence – has not yet had an impact. In his remarks, Powell repeatedly emphasized the current high level of uncertainty. This is also due to the economic policy changes made or announced by the government, for example the tariffs. It is not yet clear enough how this will affect the economy.

According to Powell, the higher inflation forecast for 2025 is at least partly due to higher tariffs, although a precise analysis is very difficult here. Overall, the Fed's baseline scenario is that the effect of tariffs on inflation is temporary. However, whether this scenario proves to be the case depends critically on long-term inflation expectations remaining anchored. Despite an increase in some survey-based measures of inflation expectations, most indicators – particularly those based on financial markets – still point to stable expectations.

In view of the high level of uncertainty, patience is obviously the order of the day for the Fed. Powell wants more “clarity” before the Fed changes its key rates. This is likely to be the case once the government's key decisions have been made. Powell also repeated his earlier statement that the Fed is “in no hurry” to change interest rates.

Overall, we feel vindicated in our forecast that the Fed will only lower rates by 25 basis points towards the end of the year. We expect a further move at the beginning of 2026.

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