Fed's 'risk management cut' sparks confusion amid mixed signals

Image source: iStock/Insjoy

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Key points

- The Fed conducted its first rate cut since the end of last year and lowered the key rate from 4.25-4.5% down to 4.0-4.25%. Surprisingly, there was a stronger than expected consent with only new Fed governor Miran, a President Trump nominee, dissented for a larger, half percentage cut.
- The new Fed projections show a 'median' forecast of 2 more rate cuts this year, but Powell explained that 'this is not a committee plan' and 'one should see this as 10 committee members expecting 2 or more rate cuts this year, but 9 members expecting fewer than 2 cuts – or even, in fact, no cut'.
- The new economic projections caused some confusion: median inflation expectations for 2026 and 2027 were revised higher, while unemployment forecasts for the next two years were lowered. Normally, that would suggest less rate cuts, yet the new FOMC outlook shows more cuts ahead. Powell explained that yesterday's move was a 'risk management cut', citing new data that points to a higher risk of a faster weakening of the labour market.
- We stick to our baseline view of a maximum of one more rate cut this year, with a clearly increased risk of seeing 2 cuts until the end of 2025.

The US central bank cut its key rate by a quarter of a percentage point from 4.25-4.5% down to a 4.0-4.25% target range, in line with the majority of market expectations. Interestingly, there was only one dissenter: the new Fed governor Stephen Miran, who was nominated by President Trump, preferred to conduct a large cut of half a percentage point. One could have expected to see also 'dovish' dissenters from the meeting in July, Michelle Bowman or Christopher Waller, to have voted for a larger cut.

The changes in the new Fed statement versus the old one highlight the FOMC's delicate assessment of both sides of the equation: while it added new parts that focused on slowing job gains, a higher unemployment rate and rising downside risks to employment, it also newly states that inflation has 'moved up' and repeats the elevated level of inflation. Finally, it acknowledges the shift in the balance of risks towards a weaker job market – being the reason for the rate cut.

Now it gets confusing: the new summary of economic projections

Against this backdrop, it was interesting to see that the updated Summary of Economic Projections (SEP)—the Fed committee members' forecasts last released in June—did not show higher unemployment. Instead, the projections indicated a steady rate of 4.5% for 2025, followed by lower rates in 2026 and 2027, revised from 4.5% and 4.4% down to 4.4% and 4.3% respectively. The confusion grew when looking at the changes of the inflation projections, as the PCE forecasts for core and headline did not change for 2025, but were increased for 2026 from 2.4% up to 2.6%—substantially above the FED target of 2%.

The surprise deepened when looking at the new median projection for the federal funds rate. The Fed's key rate forecasts were substantially lowered: for 2025, from 3.9% in the June projections to 3.6%, implying two additional cuts now expected by the 'median' FOMC member. The projections also show a year-end rate of 3.4% in 2026 and 3.1% in 2027, compared with 3.6% and 3.4% in June. In other words, the Fed's forecasts for the key factors of its dual mandate—price stability and maximum employment—show more inflation and less unemployment, which would usually speak for fewer rate cuts, yet the Fed projected more instead.

The so-called 'dot plot', in which FOMC members indicate their individual projections for the year-end federal funds rate, revealed the presence of a new 'super-dove'. One projection stood out well below the rest, showing a 2.9% key rate forecast at the end of 2025. This dot likely belongs to the new Fed governor Miran (see figure below).

The press conference: Powell explains contradictions in the new projections and calls yesterday's move a 'risk management cut'

In the press conference, Powell explained the mixed signals from the FOMC's projections and called today's rate cut a 'risk management cut'. He explained that risks in the labour market had increased following sharp downward revisions to payroll data between April 2024 and March 2025. However, he later cautioned that 'one should also not put too much weight on the non-farm payroll numbers'. When asked about the rising inflation with CPI now almost a full percentage point above the 2% goal, Powell admitted being in the challenging situation with downside risks in the labour market while having upside risks for inflation.

He emphasised the Fed's shift in its risk assessment, giving greater weight to downside risk in the labour market. In line with its mandate, this justified lowering the key rate toward the neutral level. At the same time, he reiterated the Fed's commitment to ensuring that tariff-induced price increases do not create more than just one-time effects on inflation.

He stressed that although the 'dot plot' reflects individual Fed members' expectations, it does not represent a committee plan. Monetary policy, he added, is 'not on a pre-set course', and the Fed remains 'in a meeting-by-meeting situation, looking at the data'. Interestingly, Powell later stressed that in the 'dot plot' there are '10 committee members expecting 2 or more rate cuts this year but 9 members expecting fewer than 2 cuts – or even, in fact, no cut'.

When asked about potential difficulties to the Fed's independence following the appointment of Governor Miran—who still serves as the President's chair of the Council of Economic Advisors—Powell replied that the FOMC remains 'united in pursuing our dual mandate goals' and is 'strongly committed to maintaining our independence'.

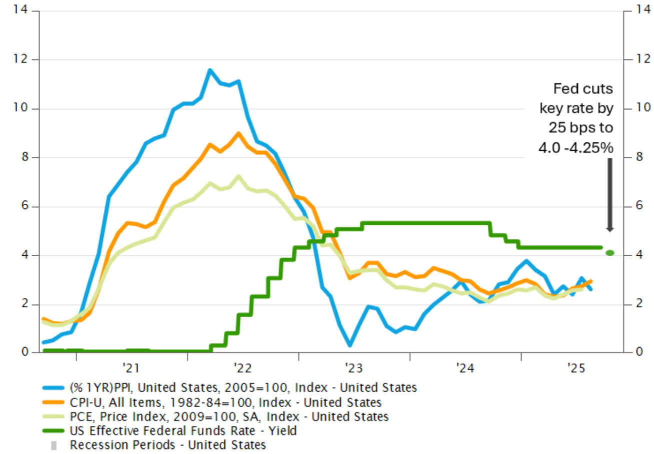
Powell tried to explain the committee's view that there is 'a curious balance' between much lower labour supply, due to new immigration policies, and a simultaneous drop in demand. Similar to what he said during his Jackson Hole speech, he added that now 'we saw demand coming down more sharply with the unemployment rate edging up'.

What did markets do and how do we see our baseline scenario evolve?

Interestingly, US treasury yields dropped first before edging higher, above the level ahead of the meeting – more pronounced at the belly and the longer end of the curve. Similarly, the USD index initially depreciated before appreciating during the press conference, reaching levels above those seen ahead of the meeting.

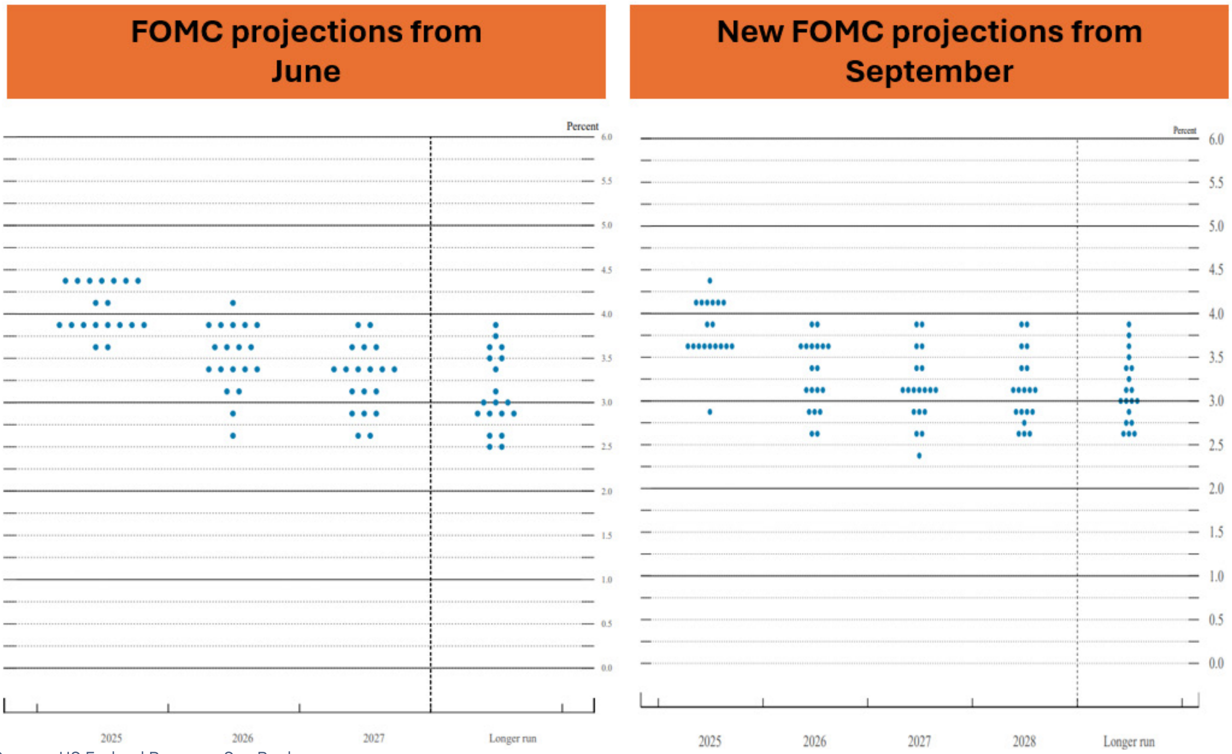
Last night's news suggests that there is not yet a final verdict on the Fed's future rate path for 2025. We view the rate cut, as Powell described it, as a 'risk management cut'. Given the contradictions in the FOMC's projections, Powell's comments regarding the two groups of 'doves' and 'hawks', the discrepancies between their views, and our own expectation of further rising inflation, we maintain our baseline scenario of only one more (or possibly no) rate cut this year, while acknowledging an increased probability of two additional cuts in the final two meetings.

1. Inflation is rising and Fed is cutting



Source: US Federal Reserve, Syz Bank

2. The "dot plot" shows a "dovish" move for some FOMC members' forecasts



Source: US Federal Reserve, Syz Bank

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