Economic Update

May 28, 2025

FOMC Minutes: "Unusually Elevated" Uncertainty from Tariffs, With Downside Risks to Growth, Upside Risks to Inflation

- **There was great uncertainty about the economic outlook due largely to tariffs, according to the minutes from the FOMC's early May meeting.**
- **Risks to growth were to the downside and risks to inflation were to the upside.**
- **Economic conditions were generally solid in early 2025, although inflation remained somewhat above the FOMC's 2% objective.**
- **The FOMC kept the fed funds rate unchanged amid elevated uncertainty, and signaled that the rate was unlikely to change in the near term.**
- **PNC expects a fed funds rate cut in late 2025, with additional rate cuts in early 2026.**

Federal Open Market Committee participants reported "uncertainty about their economic outlooks as unusually elevated" at their meeting on May 6 and 7, according to the meeting minutes. The uncertainty came largely from tariffs announced by the Trump administration, which were "significantly larger and broader than [participants] had anticipated." Participants noted "considerable uncertainty surrounding the evolution of trade policy as well as about the scale, scope, timing, and persistence of associated economic effects." In addition, they noted "significant uncertainties also [surrounding] changes in fiscal, regulatory, and immigration policies and their economic effects."

The net effect was an overall view that "downside risks to employment and economic activity and upside risks to inflation had risen, primarily reflecting the potential effects of tariff increases."

Although uncertainty had increased with new trade policies, the economy was in decent shape in the first part of 2025, as "economic activity had continued to expand at a solid pace and labor market conditions continued to be solid." Inflation, while down from its peak in 2022, "remained somewhat elevated relative to the Committee's 2% goal." In addition, "progress on disinflation had been uneven" in early 2025. Participants expected tariffs to add to inflationary pressures this year, although with a great deal of uncertainty. Some participants worried that an increase in inflation expectations could lead to higher inflation over the medium term, which would make the FOMC's task of returning inflation to 2% more difficult.

Although the labor market was generally in good shape of the time of the meeting, there was some discussion of anecdotal reports of a hiring slowdown because of increased uncertainty. Consumer spending growth held up in early 2025, although participants noted a drop in consumer sentiment. There was concern that tariffs could become a drag on consumer spending through higher prices and greater uncertainty.

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Participants also noted a tariff-driven drop in business sentiment in the first quarter, with firms "pausing or delaying their capital expenditure plans." There was also a view that "sentiment was generally downbeat among manufacturers" due to actual or potential higher costs from tariffs. Government spending cuts were reported to be a drag on healthcare and education.

Participants discussed the increase in longer-term Treasury yields and a weaker dollar in response to higher tariffs, noting that "a diminution of the perceived safe-haven status of US assets could have long-lasting implications for the economy."

With inflation above the 2% objective, solid economic growth in early 2025, and a good labor market, but increased uncertainty from tariffs, FOMC participants thought it appropriate to keep the fed funds rate unchanged at the meeting, in a range between 4.25% and 4.50%. Greater uncertainty about the outlook made it "appropriate to take a cautious approach until the net economic effects of the array of changes to government policies become clearer. Participants noted that monetary policy would be informed by a wide range of incoming data, the economic outlook, and the balance of risks."

The minutes say that "almost all participants commented on the risk that inflation could prove to be more persistent than expected. Participants emphasized the importance of ensuring that longer-term inflation expectations remained well anchored, with some noting that expectations might be particularly sensitive because inflation had been above the Committee's target for an extended period. Participants noted that the Committee might face difficult tradeoffs if inflation proves to be more persistent while the outlooks for growth and employment weaken."

Monetary policy is on hold in the near term until the economic picture becomes clearer. With tariffs likely to both add to inflation and weigh on economic growth this year, the FOMC will wait until the impacts become clearer. PNC expects no change to the FOMC's key short-term policy rate, the federal funds rate, until the end of 2025. PNC's baseline forecast is for a 25-basis point cut in the fed funds rate at the FOMC's mid-December meeting, taking the rate to a range of 4.00% to 4.25% at the end of 2025. PNC then expects two additional fed funds rate cuts in early 2026, with the rate at 3.50% to 3.75% by the second quarter of next year, and then staying there indefinitely.

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