Macro Research

Danske Bank

31 July 2025

Research US

Fed review: FOMC divided over tariff risks

- **The Fed maintained monetary policy unchanged in July as widely anticipated. Waller and Bowman dissented in favour of a 25bp cut.**
- **Powell struck a more hawkish tone than expected, sounding more concerned about upside risks to inflation than downside risks to labour markets. Markets now price the September meeting as a coin-flip between a cut and a hold.**
- **Short-end UST yields ticked modestly higher, while EUR/USD continued to trend lower. We still see a September cut as our base case.**

The FOMC remains divided over the best course of action amid tariff uncertainty. The key question is whether the tariffs pose a larger downside risk to labour markets or an upside risk to inflation? Governor Waller hinted about a possible dissent already earlier in July and was joined by Bowman in voting for a 25bp cut. On the other end of the spectrum, Powell appeared more concerned about the risk of a one-time tariff boost to prices turning into more persistent inflation.

That said, Powell carefully avoided providing exact guidance about the September meeting, **which the markets are now pricing as a coinflip between a cut and a hold**. Ahead of the meeting, markets saw a cut as the most likely option for September (65% / 35%).

The policy statement appeared dovish in comparison. While the economic activity was previously described as having 'continued to expand at a solid pace', the updated statement noted that 'growth of economic activity moderated in the first half of the year'. Just ahead of the meeting the preliminary Q2 GDP data, which was heavily positively distorted by a decline in imports after Liberation Day, showed moderation in private domestic final demand growth.

Powell acknowledged the cooling private sector jobs growth observed over recent months but emphasized that it has been balanced by a similar slowdown in labour supply growth. The foreign-born labour force declined by more than 1.1 million in Q2 according to the BLS's household survey, putting downward pressure on the unemployment rate even when labour demand appears to cool.

For now, we agree that labour market conditions remain solid. The latest JOLTs survey showed that the ratio of job vacancies to unemployed job seekers remained steady at 1.06 – essentially unchanged from a level observed a year ago. The number of involuntary layoffs remains at historically low as well.

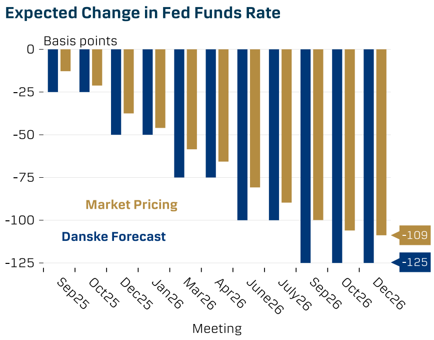
But as the trade-weighted average tariff rate appears to be settling close to 20%, rising costs will continue to put pressure on profit margins and households' real purchasing power. US importers paid more tariffs for their H1 2025 imports than they did during the entire 2024 (chart 2). We expect this to dampen new hiring and put further pressure on consumption in H2, **eventually tilting the Fed to resume cutting rates in the September meeting.**

With tariff uncertainty now easing, the focus is back on macro data. Two more jobs reports and CPI prints before the September meeting will determine the fate of further rate cuts.

Our Fed call (unchanged)

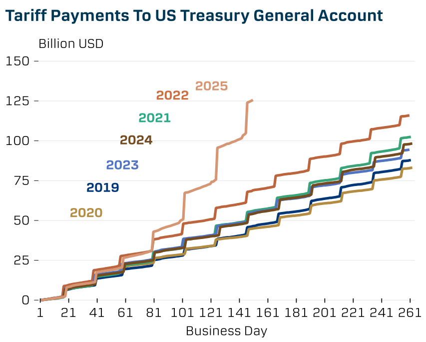
- The next 25bp rate cut in September 2025, followed by quarterly reductions until September 2026. Terminal rate forecast 3.00 -3.25%.

Chart 1: Markets now price the September meeting as a coinflip between a cut and a hold



Sources: Macrobond Financial, Danske Bank, LSEG

Chart 2: 2025 tariff payments already above end-2024 levels



Sources: Macrobond Financial, US Treasury

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Report completed: 31 July 2025 at 5:50 CET

Report disseminated: 31 July 2025 at 6:00 CET